No. 909

DEC 27 1966
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

EDWARD LIMPERIS, TRUSTEE
IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.
Petitioner,

v.

A. J. ARMSTRONG CO., INC.
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

WILLIAM S. COLLEN
100 West Monroe Street
Chicago, Illinois 60603

JOSEPH L. KADISON
134 North LaSalle Street
Chicago, Illinois 60602

WILLIAM B. DAVENPORT
135 South LaSalle Street
Chicago, Illinois 60603
Attorneys for Petitioner

UNITED STATES LAW PRINTING CO., CHICAGO 18, ILL. LAkeview 5-6581

INDEX

	PAGE
Prayer for issuance of writ of certiorari	1
Citations to opinions below	1
Jurisdiction	2
Questions presented	2
Statute involved	3
Statement	3
Reasons for granting the writ	7
Conclusion	16
Appendix A—Text of Bankruptcy Act §2a(7); 11 U.S.C. §11a(7)	App. 1
Appendix B—Opinion of the United States Court of Appeals for the Seventh Circuit filed July 29, 1966:	
Majority Opinion	App. 2
Dissenting Opinion	App. 14
Appendix C—Order of the United States Court of Appeals for the Seventh Circuit entered July 29, 1966	App. 29
Appendix D—Order of the United States Court of Appeals for the Seventh Circuit entered October 3, 1966	App. 30
Appendix E—Memorandum and Order, Opinion of the United States District Court for the Northern District of Illinois filed December 4, 1964	App. 31

TABLE OF AUTHORITIES

Cases

PAGE

American Mannex Corp. v. Huffstutler, 329 F. 2d 449 (5th Cir. 1964) 7, 14

Blank v. Bitker, 135 F. 2d 962 (7th Cir. 1943) 12

Buss v. Long Island Storage Warehouse Co., 64 F. 2d 338 (2d Cir. 1933) 9

In re Christ's Church of the Golden Rule, 172 F. 2d 523 (9th Cir. 1949) 10

Cline v. Kaplan, 323 U.S. 97 (1944) 10

Continental Cas. Co. v. White, 269 F. 2d 213 (4th Cir. 1959) 8

Damsky v. Zavatt, 289 F. 2d 46 (2d Cir. 1961) 14

In re Federal Photo Engraving Corp., 54 F. 2d 628 (2d Cir. 1931) 10

Fish v. East, 114 F. 2d 177 (10th Cir. 1940) 9

Giffin v. Vought, 175 F. 2d 186 (2d Cir. 1949) 7

Harris v. Avery Brundage Co., 305 U.S. 160 (1938) .. 13

Harrison v. Chamberlain, 271 U. S. 191 (1926) 10, 12

In re Hollingsworth & Whitney Co., 242 Fed. 753 (1st Cir. 1917) 9

Jackson v. Sports Company of Texas, Inc., 278 F. 2d 716 (5th Cir. 1960) 9, 10

Johnson v. Gardner, 179 F. 2d 114 (9th Cir. 1949), cert. denied, 339 U.S. 935 (1950) 14

Johnson v. Wilson, 118 F. 2d 557 (9th Cir. 1941) 7

Katchen v. Landy, 382 U.S. 323 (1966) 7, 12, 14, 16

PAGE

Kelso v. Maclaren, 122 F. 2d 867 (8th Cir. 1941) 10

Lieberman v. Bancroft, 69 F. 2d 202 (3d Cir. 1934) 10

MacDonald v. Plymouth County Trust Co., 286 U.S. 263 (1932) 13

O'Dell v. United States, 326 F. 2d 451 (10th Cir. 1964) 8

In re Prindible, 115 F. 2d 21 (3d Cir. 1940) 12

Roche v. Evaporated Milk Ass'n, 319 U.S. 21 (1943) .. 12

Sulmeyer v. Pfohlman, 329 F. 2d 915 (9th Cir. 1964) 11

Taubel-Scott-Kitzmiller Co. v. Fox, 264 U.S. 426 (1923) 15

Teasdale v. Robinson, 290 F. 2d 108 (8th Cir. 1961) 9, 10

Trieber v. England, 237 F. 2d 117 (9th Cir. 1956), cert. denied, 352 U.S. 967 (1957) 10, 11

Tumey v. Ohio, 273 U.S. 510 (1927) 11

Ullman, Stern & Krausse v. Coppard, 246 Fed. 124 (5th Cir. 1917) 7

Universal Oil Products Co. v. Cosden Petroleum Corp., 178 F. 2d 495 (5th Cir. 1949) 10

Statutes

Bankruptcy Act §2a(7); 11 U.S.C. §11a(7) 3, 8

§24a; 11 U.S.C. §47a 11

§39c; 11 U.S.C. §67c 11

§67d; 11 U.S.C. §107d 4

§70e; 11 U.S.C. §110e 4

PAGE

General Order 37 12
47 ..... 14, 16

Federal Rules of Civil Procedure:
Rule 12 12
Rule 54 12

Miscellaneous

Collier, Bankruptcy (14th ed. 1966):
Vol. 2, ¶23.02 14
Vol. 2, ¶40.01 11

Ferguson, The Consensual Basis of Subject-Matter Jurisdiction In Matters of Bankruptcy: Fact and Fiction, 14 Rutgers L. Rev. 491 (1960) 13, 14

Rochelle and King, A Proposal to Raise Bankruptcy Courts to District Court Level, 13 Kan. L. Rev. 391 (1965) 11

Rochelle and King, Summary Jurisdiction in Bankruptcy: Katchen v. Landy and Questions Left Unanswered, 1966 Duke L. J. 669 11

Sanborn, Committee Report to National Judicial Conference, August 21, 1944, quoted in Maclachlan, *Bankruptcy* §195, n. 24 (1956) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

NO.

EDWARD LIMPERIS, TRUSTEE IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.
Petitioner,

v.

A. J. ARMSTRONG CO., INC.
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above-entitled case on July 29, 1966.

CITATIONS TO OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 153-202) is unreported. The opinion of the District Court (R. 331-63), printed in Appendix E hereto, *infra* p.

31, is reported in 236 F. Supp. 333. The majority opinion of the Court of Appeals, printed in Appendix B hereto, *infra* p. 2, is reported in ..... F. 2d. ..... The dissenting opinion, Appendix B, *infra* p. 14, is also there reported.

JURISDICTION

The judgment of the Court of Appeals was entered on July 29, 1966. Rehearing *en banc* was denied (with the dissenting judge voting for rehearing) on October 3, 1966. Appendix D, *infra*, p. 30. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Where the bankruptcy court "obviously" has summary jurisdiction over some of the property over which a claimant asserts a possessory right and claim, is it necessary to adjudicate that claimant's rights over the remainder of the property by plenary action before the bankruptcy court's summary jurisdiction can be exercised?

2. May the bankruptcy court in the exercise of its summary jurisdiction determine the question of lawfulness of possession by one asserting the status of an adverse claimant?

3. May an intervenor in a bankruptcy proceeding—who (a) has asked the district judge to reverse the referee's appointment of a receiver, (b) entered into an agreement with the court after the court has rejected an asserted agreement between the receiver and the intervenor, and (c) filed a motion asking for the return of property in the court's possession—assert the status of an adverse claimant?

4. May the bankruptcy court, when its summary jurisdiction is challenged, conduct a combined hearing on the jurisdictional issue and the merits without a preliminary ruling on the issue of its jurisdiction, particularly where the bankruptcy court "obviously" has summary jurisdiction over some of the property?

STATUTE INVOLVED

The statutory provision involved is §2a(7) of the Bankruptcy Act, 11 U.S.C. §11a(7). It is printed in Appendix A hereto, *infra*, p. 1.

STATEMENT

This is an involuntary bankruptcy proceeding filed on November 23, 1962 involving Process-Manz Press, Inc. (R. 1, 155.) The bankrupt had, for over 90 years, operated a large printing plant occupying over half a square block in Chicago. (R. 14, 154-55, 854.) It had approximately 300 employees. (R. 14.)

In the course of the proceeding, some 500 creditors filed claims aggregating approximately $1,181,000. (R. 163, 189, 736, 749). Tax claims filed, including a claim by the United States for withheld income taxes in the amount of $107,000, aggregated about $140,000. (R. 189, 1537. Wage claims in excess of $40,000 were filed. (R. 189.) Seventeen claimants under conditional sales contracts or chattel mortgages filed reclamation petitions. (R. 186.)

Following adjudication, petitioner, trustee in bankruptcy, filed a petition to sell at public auction the assets of the bankrupt in the court's possession. (R. 50.) In response thereto, respondent, A. J. Armstrong Co., Inc., filed a motion asserting the status of an adverse claimant and praying the return to it of all these assets. (R. 60.)

Respondent's motion was predicated upon (1) an asserted lien on all the assets in the amount of $3,450,000 created under a trust deed, chattel mortgage and accounts receivable financing agreement; (2) a seizure of all the assets by respondent *two days (one of which was Thanksgiving) before the filing of the bankruptcy;* and (3) an agreement with the receiver. Petitioner opposed respondent's claim on the grounds that (1) the possession of the respondent was unlawful and (2) respondent had intervened in the proceeding (by an agreement made directly with the court after the court had rejected the asserted agreement with the receiver). Petitioner also asserted that respondent's claim to the assets was invalid since it was based on fraudulent transfers which were voidable under §§67d and 70e of the Bankruptcy Act and prayed for subordination of respondent's entire claim. (R. 83, 104, 122.)

Over the objection of respondent, the referee conducted a combined hearing on the jurisdictional issue and the merits of respondent's claim to the bankrupt's property as framed by the pleadings. The referee held 33 hearings over a period of seven months. The record thereof consists of 3,000 pages of transcript and over 125 exhibits. Respondent produced 13 witnesses and offered 66 exhibits.

At the conclusion of the hearings the referee found that respondent had intervened in the proceeding and that its possession of the bankrupt's assets was unlawful* and overruled the motion of respondent objecting to the summary jurisdiction of the bankruptcy court. The referee's order also invalidated respondent's claim to the assets on the ground of fraud voidable under §§67d and 70e of the Bankruptcy Act and subordinated respondent's claim

---

* The referee's findings on these points appear in the appendix to the dissenting opinion in the Court of Appeals, *infra*, Appendix B, pp. 18-28.

to the claims of all general creditors. The order also directed a sale of the assets free and clear of respondent's asserted lien. (R. 153-202.)

The invalidation and subordination of respondent's claim were based upon (1) respondent's demand that the major portion ($1,438,000) of a $2,500,000 loan secured by the assets of the bankrupt be used to acquire the stock of the bankrupt from two former stockholders in order that the stock could be pledged to respondent as collateral to secure the loan and (2) respondent's arrangement of and participation in the illegal redemption (coincident with the loan) of nearly $2,000,000 of the preferred stock of the bankrupt, all at a time when respondent knew that the bankrupt's cash position was extremely poor and at a time when the bankrupt was indebted to its creditors in the approximate amount of $588,000. (R. 159-62, 163-67, 192-94, 1376, 1503, 1513-14, 1533, 1555-65, 1566-67; Add. R. 25) The referee found that "the direct and proximate result" of this transaction "was to cause the bankruptcy." (R. 184, 193.)

Other bases for subordination included respondent's virtual ownership of over 91% of the stock of the bankrupt, respondent's complete control over the bankrupt's income and respondent's unconscionable conduct in its dealings with the bankrupt and its creditors over a 13-month period. (R. 164-71, 194-97.) An example of the last was respondent's financing of accounts receivable created by work done by the bankrupt; respondent paid the proceeds of these accounts to the bankrupt's parent company over the bankrupt's complaint. (R. 170-71, 814-15, 819-20.)

Respondent petitioned for review of the referee's order. (R. 208-99.) During the process of review, respondent obtained a stay of the sale of the assets by meeting the conditions of stay imposed by the referee and affirmed by both the District Court and the Court of Appeals. One of these conditions was the posting of two corporate surety

bonds aggregating $3,000,000 to protect the general creditors and the reclamation creditors from depreciation and obsolescence of the assets during the period of review. (R. 309-24, 330.)

Upon review the District Court affirmed the referee's order in its entirety, observing that the record compelled the referee to find that the transfers to respondent by the bankrupt in December, 1961 were void under §67d (2)(b), (c) and (d) of the Bankruptcy Act. The District Court also characterized respondent's conduct as "unfair, inequitable, unconscionable, and fraudulent." *In re Process-Manz Press, Inc.*, 236 F. Supp. 333, 348 (N.D. Ill. 1964).

The Court of Appeals, with Judge Swygert dissenting, reversed. The majority, *without holding a single finding of fact erroneous,* held that respondent had not intervened in the proceeding and that the question of the legality of respondent's possession was for a plenary suit, not for the bankruptcy court in the exercise of its summary jurisdiction. The majority did rule, however, that the referee had summary jurisdiction as to certain property which respondent "obviously had no right to possess." It also held that "in determining there was fraud the referee went beyond the limit for determination of summary jurisdiction." The dissenting judge would have adopted the reasoning of the District Court and affirmed the judgment. *In re Process-Manz Press, Inc.*, ... F. 2d ..... (7th Cir. 1966); Appendix B, *infra,* pp. 2, 14.

Subsequent to the filing of the appeal from the judgment of the District Court, petitioner filed, at the direction of the referee, a plenary action seeking the same relief as that granted in the summary proceeding. This action, filed to toll the statute of limitations, sought relief in the alternative pursuant to Federal Rule 8(a). (R. 1062-75.) The pleadings in this suit were certified to the Court of Appeals and were part of the record before it. (R., Vol. V, 1-122.)

REASONS FOR GRANTING THE WRIT

1. The decision below is in conflict, to the extent hereinafter stated, with decisions of other Circuits on all four questions presented.

On the first question, the holding of the court below denying *res judicata* effect in a plenary action to its holding that the referee had summary jurisdiction "with respect to property over which Armstrong took possession but which it obviously had no right to possess" conflicts in principle with decisions of the Second, Fifth and Ninth Circuits: *Giffin* v. *Vought,* 175 F. 2d 186 (2d Cir. 1949); *Ullman, Stern & Krausse* v. *Coppard,* 246 Fed. 124 (5th Cir. 1917); *Johnson* v. *Wilson,* 118 F. 2d 557 (9th Cir. 1941). Respondent claimed the equity of the bankrupt in property claimed by the reclamation creditors. (R. 261.) Since the Court below held that the referee "obviously" had summary jurisdiction as to this property, his adjudication of respondent's claim thereto is *res judicata* in a plenary action under these decisions. See *Katchen* v. *Landy,* 382 U.S. 323, 334 (1966).

In substance, the holding of the Court below that the "prolonged hearing" before the referee "must go largely for naught" means that the exercise of his conceded summary jurisdiction must be ignored pending the outcome of a plenary action.

On the second question (determination of possession), the decision of the Court below conflicts in principle with that of the Fifth Circuit in *American Mannex Corp.* v. *Huffstutler,* 329 F. 2d 449 (5th Cir. 1964). The Fifth Circuit there noted:

> "We accept the proposition that [the pipe] was under the dominion and control of respondent Mannex

> [adverse claimant] and had been since September 25 when the actions, here under review, occurred. Far from recognizing this physical fact as any obstacle, the Trustee-appellee contends that the pipe was in the 'constructive' possession of Trice [bankrupt], and this is enough both as to the form of the proceeding and the substantive rights. We recognize, of course, that there is a vast amount of case law which speaks in these terms. But it seems to us that the matter is greatly simplified by approaching it for what it really is—the question whether the party has a *legal right* to maintain the actual, physical possession." 329 F. 2d at 451.

Even if respondent's claim to the assets which it seized was real and substantial, the lawfulness of respondent's possession of those assets was still a question for the bankruptcy court in determining the issue of its own jurisdiction under the decision in *Mannex*.

On the third question (the assertion by an intervenor of the status of an adverse claimant), the holding below conflicts with that of the Tenth Circuit in *O'Dell* v. *United States*, 326 F. 2d 451 (10th Cir. 1964), where the Court held that the claimant, by filing a motion to impound certain funds, had invoked and thereby consented to the summary jurisdiction of the bankruptcy court and could not thereafter challenge it. The decision below also conflicts in principle with that of the Fourth Circuit in *Continental Cas. Co.* v. *White*, 269 F. 2d 213, 216 (4th Cir. 1959), in which the court observed that the 1952 amendment to §2a(7) of the Bankruptcy Act was not intended to diminish the jurisdiction of the bankruptcy court where the creditor has come into court voluntarily—in that case by filing a claim.

The respondent here invoked the jurisdiction of the District Court voluntarily (1) in asking it to reverse the referee's order appointing a receiver for "a selfish mo-

tive"—"the collectibility of a million dollars worth of receivables" (R. 1766-72, 1773-74, 1775), (2) in agreeing to an order which provided that neither petitioner nor respondent should be prejudiced "in making or advancing of any contention which * * * either * * * might make with respect to questions of possession, the right to return thereof, jurisdiction, validity or otherwise" (R. 36; Add. R. 20-21), and (3) in filing a motion asking for the return of property (R. 60). Cf. *In re Hollingsworth & Whitney Co.*, 242 Fed. 753, 755-56, 758-59 (1st Cir. 1917).

On the fourth question, a conflict exists among the Circuits concerning the scope of a hearing when summary jurisdiction is challenged. The Court below held that the referee improperly "fused the inquiry into his summary jurisdiction with a trial on the merits." A similar view has been expressed by the Fifth Circuit. *Jackson* v. *Sports Company of Texas, Inc.*, 278 F. 2d 716, 718-19 (5th Cir. 1960). The Second, Eighth and Tenth Circuits have taken an opposite view, at least under circumstances similar to those present here. *Buss* v. *Long Island Storage Warehouse Co.*, 64 F. 2d 338 (2d Cir. 1933); *Teasdale* v. *Robinson*, 290 F. 2d 108 (8th Cir. 1961); *Fish* v. *East*, 114 F. 2d 177, 189 (10th Cir. 1940). In *Buss* the Second Circuit observed:

> "Two questions arise: The summary jurisdiction of the bankruptcy court; Cochrane's right to stop the goods *in transitu*. It chances that the two coalesce, so we proceed to the merits first." 64 F. 2d at 339.

In *Teasdale* v. *Robinson, supra,* the Eighth Circuit observed:

> "The Referee in bankruptcy held a hearing upon the question of his jurisdiction, as well as upon the merits of the Trustee's petition. That was proper practice, and counsel for the Robinsons did not contend otherwise, but throughout the hearing preserved objection to the exercise of summary jurisdiction by the Referee." 290 F. 2d at 112.

The Fifth Circuit noted this inconsistency in *Jackson* v. *Sports Company of Texas, Inc., supra,* 278 F. 2d at 717.

The decision below also conflicts in principle with those of the five Circuits which have ruled upon the question and have uniformly held that an order sustaining summary jurisdiction only, without deciding the merits, is interlocutory and therefore not appealable. *In re Federal Photo Engraving Corp.,* 54 F. 2d 628 (2d Cir. 1931); *Lieberman* v. *Bancroft,* 69 F. 2d 202 (3d Cir. 1934); *Universal Oil Products Co.* v. *Casden Petroleum Corp.,* 178 F. 2d 495 (5th Cir. 1949); *Kelso* v. *Maclaren,* 122 F. 2d 867 (8th Cir. 1941); *Trieber* v. *England,* 237 F. 2d 117 (9th Cir. 1956), *cert. denied,* 352 U.S. 967 (1957); *In re Christ's Church of the Golden Rule,* 172 F. 2d 523 (9th Cir. 1949). These decisions in substance permit the denial on a reserved basis of a motion challenging summary jurisdiction and a combined hearing on jurisdiction and the merits and require participation on the merits by the adverse claimant.* They explain the quoted view of the Eighth Circuit in *Teasdale* v. *Robinson,* 290 F. 2d 108 (8th Cir. 1961).

2. This Court should re-examine *Harrison* v. *Chamberlain,* 271 U.S. 191, 194 (1926), upon which the majority opinion below relies, in the light of developments in the past forty years. The inconsistency in the decisions concerning the scope of a hearing when the summary jurisdiction of a bankruptcy court is challenged may be traced to language therein that "the court may enter upon a *preliminary inquiry* to determine whether the adverse claim is real and substantial or merely colorable." (Emphasis supplied.)

---

* Participation on the merits does not waive a timely objection to summary jurisdiction. *Cline* v. *Kaplan,* 323 U.S. 97, 100 (1944).

The earlier reluctance on the part of this Court and many Courts of Appeal to view the exercise of summary jurisdiction by referees in bankruptcy in a favorable light was attributable to prejudice prevalent during the years when the compensation of referees was based on a percentage of assets administered. See Rochelle and King, *Summary Jurisdiction in Bankruptcy: Katchen* v. *Landy and Questions Left Unanswered,* 1966 Duke L. J. 669, 671. The direct financial interest of the referee in the outcome of a proceeding before him was understandably a basis for this reluctance. Cf. *Tumey* v. *Ohio,* 273 U.S. 510 (1927). In 1946 the Referees' Salary Act eliminated the fee system of compensation and established a salary system under the supervision of the Judicial Conference of the United States and the Administrative Office of the United States Courts. See 2 COLLIER, BANKRUPTCY ¶40.01 (14th ed. 1966); Rochelle and King, *A Proposal to Raise Bankruptcy Courts to District Court Level,* 13 Kan. L. Rev. 391, 393 (1965). With the enactment of this legislation the ground for this underlying prejudice was eliminated.

Also, since 1926 the Courts of Appeal of five Circuits have uniformly established the non-appealability for want of finality of an order determining only that summary jurisdiction exists. See cases cited *supra,* p. 10.* The Third

---

* The assertion of an adverse claim presents "a controversy arising in proceedings in bankruptcy" under Bankruptcy Act §24a, 11 U.S.C. §47a, which governs appeals from a District Court to a Court of Appeals. Review of action of the referee by the District Court is governed by Bankruptcy Act §39c, 11 U.S.C. §67c. While a District Court may in its discretion review an order of a referee determining only that summary jurisdiction exists [and if it does so, this is not a ground for complaint by the trustee in the Court of Appeals, *Sulmeyer* v. *Pfohlman,* 329 F. 2d 915, 917 (9th Cir. 1964)], the District Court is not obligated to review such an order. *Trieber* v. *England,* 237 F. 2d 117 (9th Cir. 1956), *cert. denied,* 352 U.S. 967 (1957), involved such an order, an appeal of which was dismissed at all levels of review.

Circuit has observed that the requirement of finality as a condition of appeal "applies equally to action taken by a referee in bankruptcy." *In re Prindible,* 115 F. 2d 21, 22 (3d Cir. 1940). The point in a proceeding at which a referee determines that he will hear the merits—whether at the outset or in the middle—is immaterial from a practical standpoint.

Two factors made the instant case one appropriate at the outset for a combined hearing on jurisdiction and the merits: (1) the intermixture of property seized by respondent, some of which, as the Court below held, it "obviously had no right to possess", and (2) the complicated factual issues presented by the pleadings. The referee observed, "To separate these matters completely might be difficult." (R. 471.) *Harrison* v. *Chamberlain,* 271 U.S. 191 (1926), involved neither of these factors, only a specific fund of money held by a stranger to the proceeding.

Harrison v. *Chamberlain* has become obsolete as a guideline for the conduct of hearings before the bankruptcy court in the exercise of its summary jurisdiction. This Court should reconsider *Harrison* v. *Chamberlain* in the light of the foregoing developments. It should clarify that the practice in bankruptcy litigation in this respect follows the practice in civil and criminal litigation. See General Order 37; Federal Rules of Civil Procedure 12(b) and 54; *Blank* v. *Bitker,* 135 F. 2d 962 (7th Cir. 1943); and *Roche* v. *Evaporated Milk Ass'n,* 319 U.S. 21 (1943).

3. The questions presented are important in the uniform and proper administration of the bankruptcy laws.

The ruling of the Court below frustrates the chief objective of the bankruptcy laws, " 'to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period.' " *Katchen* v. *Landy,*

382 U.S. 323, 328 (1966). An otherwise meaningful remedy to creditors is thereby emasculated. The ruling undermines the concept of possession as the basis for the exercise of summary jurisdiction. It furnishes an incentive to illegal seizure by any claimant standing to benefit from the delay inherent in a plenary proceeding.

Although phrased in terms of jurisdiction, the issue of summary versus plenary jurisdiction has always been regarded as one of procedure. *Harris* v. *Avery Brundage Co.*, 305 U.S. 160, 164 (1938); *MacDonald* v. *Plymouth County Trust Co.*, 286 U.S. 263, 267-68 (1932). Litigation over this issue is frequent. Moreover, it is wasteful. The instant controversy on this wholly procedural point has already imposed an idleness on the assets in question for almost four years. The annual cost of maintenance and preservation of these assets has been $175,000. (R. 318.) The total cost since February 14, 1963, the date of filing of respondent's motion objecting to summary jurisdiction, has been almost $700,000.

Note has been taken of the great waste involved in this type of litigation. SANBORN, COMMITTEE REPORT TO NATIONAL JUDICIAL CONFERENCE, August 21, 1944, quoted in MACLACHLAN, BANKRUPTCY §195, n. 24 (1956); Ferguson, *The Consensual Basis of Subject-Matter Jurisdiction In Matters of Bankruptcy: Fact and Fiction*, 14 Rutgers L. Rev. 491 (1960). In his cited article Professor Clarence Clyde Ferguson, Jr. (now Dean and Professor of Law at Howard University) observes (at p. 491):

> "Yet, when jurisdictional doctrine becomes so confused as to become a fertile source of wasteful, asset draining litigation rather than an intelligible guide to efficient adjudications and administrations, then the state of such doctrine itself might be characterized as at least a current problem of bankruptcy administration."

The author subsequently (at p. 513) summarizes:

> "The matter of summary v. plenary, however, might, in the light of the real differences between the two proceedings, amount to little more than a tempest in a teakettle were it not for the right to jury trial."

Significantly, respondent has no right under the Seventh Amendment or Federal Rule 38 to a jury trial in a plenary suit—one in equity to avoid fraudulent transfers. *Damsky* v. *Zavatt,* 289 F. 2d 46, 53 (2d Cir. 1961); *Johnson* v. *Gardner,* 179 F. 2d 114 (9th Cir. 1949), *cert. denied,* 339 U.S. 935 (1950). The judgment of the Court below accords respondent no procedural advantage that it did not enjoy in the summary proceeding. In his above cited article (at p. 516) Professor Ferguson advocates adoption of the following view in this situation:

> "Where there is no right to a plenary proceeding *with* jury trial, the bankruptcy court ought to adjudicate the complete controversy. The mere claim to a plenary proceeding without the additional right of trial by jury is not sufficiently substantial to overcome the interests in finality of adjudication and speedy and expeditious administration of the estate, since summary adjudication, fairly conducted, clearly affords the adverse claimant due process."

In connection with Professor Ferguson's suggestion, note may be taken of the observation of the Fifth Circuit in *American Mannex Corp.* v. *Huffstutler,* 329 F. 2d 449 (5th Cir. 1964), at 450, in footnotes 1 and 2 and the accompanying text; of General Order 47; and of 2 COLLIER, BANKRUPTCY ¶23.02, p. 442 (14th ed. 1966).

4. The majority opinion below is plainly erroneous. It is in conflict with decisions of this Court. It ignores the climate created by this Court's most recent decision on summary jurisdiction, *Katchen* v. *Landy,* 382 U.S. 323

(1966). No decision supports (or is cited to support) the holding below that the question of lawfulness of possession is one for the plenary rather than for the summary proceeding. In *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U.S. 426 (1923), this Court observed that a bankruptcy court

> "... may conclude, where it lacks actual possession, that the physical possession held by some other persons is of such a nature that the property is constructively within the possession of the court." 264 U.S. at 433.

The decision below is internally inconsistent. Respondent's claim to the right to seize the property in question is derived from one set of documents: a trust deed, a chattel mortgage, an installment note and a letter requiring a fifteen day notice by registered mail for an actionable default. No such notice was given. The chattel mortgage specifically excludes "any goods, wares or merchandise which are dealt in or sold by [the bankrupt] in its regular course of business." Yet respondent seized this specifically excluded property and the reclamation creditor property and asserted the position of an adverse claimant with respect to all of that property.

Paradoxically, the majority opinion below holds that respondent "obviously had no right to possess" the excluded inventory and the property claimed by the reclamation creditors and yet holds that the questions of (1) the propriety of respondent's seizure of the balance of the property and (2) the merits of respondent's claim to *all* property seized by it must be deferred to a plenary suit. The majority's perplexing opinion in this respect presents untold complexities in the administration of this very substantial bankrupt estate.

In short, after conceding that the referee "obviously" had summary jurisdiction to adjudicate respondent's claim to some of the property (which required consideration of the merits), the Court below somehow determined that unless his adjudication was binding on all property seized by respondent, it was binding on none. No authority is cited for this startling proposition. The requirement of a plenary suit was held a "meaningless gesture" under similar circumstances in *Katchen* v. *Landy*, 382 U.S. 323, 334 (1966).

A hostile philosophy concerning the exercise of summary jurisdiction by referees in bankruptcy permeates the majority opinion below. The opinion relies entirely upon decisions rendered at a time when reviewing courts looked with a jaundiced eye upon the exercise of summary jurisdiction by referees. The reason for the prejudice has been removed, but the prejudice lingers on in the majority opinion. The opinion leaves the impression that if the findings and conclusions had been reached initially by a district judge, the point of view would be different. It entirely ignores the fact that they have been fully approved by the chief district judge (before whom respondent could have offered additional evidence under General Order 47).

CONCLUSION.

The problems presented by this petition deserve, if indeed they do not demand, the attention of this Court. Economy and expedition are dominant considerations in the administration of the Bankruptcy Act. In cases like the instant one they may be achieved without sacrifice of any procedural right. This Court should initiate a change in the philosophy of the Courts of Appeal toward the exercise of summary jurisdiction by referees in bankruptcy.

At a time when the backlog of pending cases is mounting to an alarming state, antiquated procedural methods which have no relationship to the merits of a controversy and which require senseless, circuitous litigation should be discarded in the interest of promoting prompt justice. The continuing great waste in litigation over the wholly procedural point of summary jurisdiction can be substantially reduced by a clarification from this Court.

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

WILLIAM S. COLLEN
JOSEPH L. KADISON
WILLIAM B. DAVENPORT
Attorneys for Petitioner

APPENDIX A

Bankruptcy Act §2a(7), 11 U.S.C. §11a(7)

The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, with their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * *

Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction.

* * *

APPENDIX B

In the

United States Court of Appeals

For the Seventh Circuit

No. 15086 SEPTEMBER TERM, 1965 APRIL SESSION, 1966

In the Matter of
PROCESS-MANZ PRESS, INC.,
Bankrupt,

A. J. ARMSTRONG CO., INC.,
Appellant

v.

EDWARD LIMPERIS,
Successor Trustee,

MIEHLE-GOSS-DEXTER, INCORPORATED, HARRIS-INTERTYPE CORPORATION, BULKLEY DUNTON & CO., DIVISION OF CARTER RICE STORRS & BEMENT, INC., BERKSHIRE PAPERS, INC., MIDLAND PAPER COMPANY and RELIABLE PAPER COMPANY,
Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

July 29, 1966

Before SCHNACKENBERG, KILEY and SWYGERT, *Circuit Judges.*

KILEY, *Circuit Judge.* A. J. Armstrong Company, Inc., appeals from a judgment of the district court affirming

orders of a referee in the Process-Manz bankruptcy proceeding which rejected Armstrong's challenge of the referee's summary jurisdiction, invalidated as fraudulent conveyances certain security transactions between Armstrong and the bankrupt which secured a loan of $2,500,000.00, subordinated Armstrong's claims (asserted to exceed $3,750,000.00) to those of all general creditors, and directed a sale[1] of the bankrupt's assets free from the liens of the asserted security transactions. *In re Process-Manz Press, Inc.*, 236 F. Supp. 333 (N.D. Ill. 1964). We reverse.

Process-Manz, the bankrupt, was, on December 14, 1961, in the printing business in Chicago, Illinois. On October 4, 1961, Manz had borrowed from A. J. Armstrong, a New York financial institution, $1,000,000.00. On December 14, 1961, Manz borrowed from Armstrong an additional $2,500,000.00 and to secure the loan executed a trust deed of its Chicago real estate and a chattel mortgage of its personal property, exclusive of inventory and work-in-progress.[2] On November 21, 1962, Armstrong, assertedly because of Manz's default in payments on the loan, took possession of the Manz real estate, machinery, equipment, and other personal property, changed the locks on doors,

---

[1] This court on February 7, 1964, affirmed an order by the district court for a stay of the sale conditioned upon a surety bond of $3,000,000.00 and payment of auctioneer's expenses preparing for the sale. The conditions were fulfilled by Armstrong and the sale stayed. *In the Matter of Process-Manz Press, Inc., Bankrupt—Armstrong, Inc.* v. *Curtis*, No. 14506.

[2] Prior to this date Armstrong required and received, as collateral for the proposed loan, all of the interest and rights to the shares of stock of Manz and a contract for the assignment of all of Manz's accounts receivable. See the district court's opinion, 236 F. Supp. at 338, for distribution of the proceeds of this loan.

posted signs giving notice that it had taken possession and was holding the property exclusively in its name, and employed guards to police and patrol the premises. On Friday, November 23, 1962, an involuntary petition in bankruptcy was filed against Manz. On November 26 a receiver was appointed, and on review the district court approved the appointment.

Thereafter, on November 27, Armstrong and the receiver entered into an agreement whereby the receiver went into possession of the bankrupt's property. On January 31, 1963, Manz was adjudicated bankrupt, and the same day Armstrong demanded possession of the Manz property. The demand was rejected. Meanwhile, Armstrong continued to advance funds for the operation on the Manz printing business, under agreement with the receiver. On February 15, 1963, a trustee was named. Armstrong continued to advance monies for the operation of the business by the trustee until February 19, 1963.

In the interim, on February 4, 1963, the receiver filed a petition, subsequently adopted by the trustee, to sell the bankrupt's assets. Armstrong objected to the sale, asserting an adverse claim to all of the assets by virtue of its security interest obtained on December 14, 1961, and its possession on November 21, 1962. It objected to the referee's summary jurisdiction, insisted that the receiver's possession was in Armstrong's behalf, and that without its consent the bankrupt's assets could not be sold. It asked for determination that it was an adverse claimant and moved to dismiss the petition to sell the assets. The trustee responded that the security transactions underlying the claim were invalid, denied Armstrong was a bona fide adverse claimant, and prayed for subordination of Armstrong's claim to the claims of all general creditors.

The referee's order[3] on November 27, 1963, denied Armstrong's motion to dismiss, declared the security transactions void as liens, claims, or encumbrances, subordinated the Armstrong claim in its entirety to all other claims filed and allowed, and directed the trustee to sell the assets free and clear of Armstrong's claims. Armstrong petitioned for review of this order and a subsequent order implementing the direction to sell. The district court, in an exhaustive opinion, adopted and affirmed the referee's findings of fact and conclusions of law, and denied the prayer of the petition for review. 236 F. Supp. 333, 350.

The vital question presented by Armstrong is whether the referee in bankruptcy had jurisdiction to invalidate the security transactions between Armstrong and the bankrupt, and to subordinate Armstrong's claim to those of all general creditors. It contends the referee should have conducted a preliminary hearing on the issue of its claim to adverse possession, and that he erred in hearing and deciding the merits of the claim.

The district court's opinion held adversely to this contention on the grounds that Armstrong recognized the possession of the court, and rendered its demand for possession "in effect a reclamation petition," when on January 31, 1963, Manz was adjudicated bankrupt, and Armstrong sought return of possession from the trustee; that whatever possession Armstrong may have had on November 21, 1962, was surrendered to the receiver when he went

---

[3] The hearing upon the trustee's petition, Armstrong's motion and trustee's response began April 1, 1963. The parties agree that the order on appeal, entered November 27, 1963, is in 66 pages and was preceded by 33 hearings with over 3,000 pages of testimony and over 125 exhibits.

into physical possession of the property; and that Armstrong had participated in the hearing in the district court on review of the appointment of receiver and had consented thereby to the summary jurisdiction. The district court affirmed the referee's orders. We think this was error.

The agreement between Armstrong and the receiver shows that in surrendering possession Armstrong did not relinquish its adverse claim. It is true that the district court rejected a provision of the agreement between Armstrong and the receiver which required the receiver to restore Armstrong to the same position it had at the time the bankruptcy petition was filed, but the referee's order of December 7, 1962, provided *inter alia* that "the rights of and questions of jurisdiction as to, and possession of A. J. Armstrong Company, Inc., shall be considered and determined in all respects as of the time of the filing of the above proceedings. . . ." Furthermore, the order provided that neither the receiver nor Armstrong would be prejudiced in making or advancing any contention with respect to possession, jurisdiction, and other matters not pertinent. Moreover, Armstrong necessarily recognized possession in the court when it requested a return of the property in accordance with its agreement with the referee. It persisted in this request, as it had from the beginning in its claim of adverse possession and denial of summary jurisdiction of the referree. And we have read the transcript of the proceeding before the district court on review of the appointment of receiver and are unable to agree with the district court that in its appearance and participation there Armstrong backed off from its resistance of summary jurisdiction, or consented to the referee's decision upon the merits.

The basic concept underlying summary jurisdiction is possession of the property. 5 MOORE, FEDERAL PRACTICE ¶ 38.30[3], at 219 (2d ed. 1964). The bankruptcy court has power in the first instance to determine whether it has actual or constructive possession essential to its jurisdiction to proceed. *Harris* v. *Brundage Co.*, 305 U.S. 160, 163 (1938).

It is well settled, however, that a bankruptcy court is without jurisdiction to summarily adjudicate a controversy without consent of the adverse claimant; that mere assertion of an adverse claim does not oust the court of its summary jurisdiction; that a preliminary determination should be made as to whether the claim is real and substantial or merely colorable; that if merely colorable the court may proceed to adjudicate the merits summarily, but if otherwise it must dismiss the summary proceeding; and that an actual claim may be adverse and substantial even though in fact fraudulent and voidable. *Harrison* v. *Chamberlain*, 271 U.S. 191, 193-4 (1926); *Cline* v. *Kaplan*, 323 U.S. 97, 98-99 (1944); *In re Kansas City Journal-Post Co.*, 144 F.2d 812 (8th Cir. 1944). See generally 2 COLLIER, BANKRUPTCY ¶ 23.07 (14th ed. 1964).

The bankruptcy court is without summary jurisdiction to determine a claim without the claimant's consent where it is necessary to weigh the force of opposing credible evidence on a substantial and controverted issue of controlling fact. *In re Kansas City Journal-Post Co.*, 144 F.2d at 815. A claim is substantial if it " 'discloses a contested matter of right involving some fair doubt and reasonable room for controversy,' . . . in matters either of fact or law; and is not to be held merely colorable unless the preliminary inquiry shows it is so unsubstantial and obviously insufficient, either in fact

or law, as to be plainly without color of merit, and a mere pretense." *Harrison* v. *Chamberlin,* 271 U.S. at 195. The Supreme Court there found the objection to summary jurisdiction well taken because the validity of the claim depended upon disputed facts as to which there was a conflict of evidence and a controversy in a matter of law.

This court gave early expression to the same rule in *In re Goldstein,* 216 Fed. 887 (7th Cir. 1914), *i.e.,* that the bankruptcy court may proceed summarily to the point of ascertaining whether the claim has substance or not. "But substantiality appears as soon as the claimant, in response to the rule to show cause, presents his verified answer, which is unmet by the trustee, or which, if met by a replication, is supported by sworn testimony of facts which, *if true,* would show title and possession antedating the petition in bankruptcy." 216 Fed. at 888-89. (Emphasis added.) See also 6 MOORE, FEDERAL PRACTICE ¶ 56.04[3] (2d ed. 1965).

It is clear to us that at no time from the beginning to the end of the proceeding before the referee did Armstrong submit to the summary jurisdiction of the court in the disposition of its claim. From the beginning of the hearing of testimony the referee insisted upon hearing all of the evidence, and did not rule on Armstrong's objection to summary jurisdiction until making its decision as well upon the merits. It is true that had Armstrong participated, instead of refusing, as it claims, to participate in the complete hearing, and presented all of its evidence, it would not have waived the question of jurisdiction. *Cline* v. *Kaplan,* 323 U.S. 97 (1944). On the other hand, it was not required to participate on the merits, but was entitled to take the risk that if it was wrong on the jurisdictional question it would ultimately

have judgment entered against it upon the evidence that was adduced before the referee. Accordingly, we hold that Armstrong did not consent to summary jurisdiction and that the referee should not have assumed jurisdiction to hear all of the evidence in order to determine whether the Armstrong adverse claim was substantial or merely colorable.

We need not discuss cases relied on by the trustee, to affirm the judgment, where there was no controversy over facts or law. This case is not of that kind. And cases cited by the trustee, such as *American Mannex Corp.* v. *Huffstutler*, 329 F.2d 449 (5th Cir. 1964) (where the court, not the referee, was held to have correctly decided there was no arguable factual basis for the claim), and *Buss* v. *Long Island Storage Warehouse Co.*, 64 F.2d 338 (2d Cir. 1933), applied the rules we have stated above to facts widely different from those before us.

The referee here found that the transfers of December 14, 1961, between Armstrong and the bankrupt were fraudulent and void under Sec. 67(d)(2)(b-c-d) of the Bankruptcy Act, 11 U.S.C. § 107(d)(2)(b-c-d), and under certain provisions of the Illinois Fraudulent Conveyancing Act and Illinois Business Corporation Act, made part of federal law by Sec. 70(e) of the Bankruptcy Act, 11 U.S.C. 110(e). The pleadings of a receiver or trustee claiming fraud do not of course subject an adverse claimant to summary jurisdiction over the latter's objection. 2 COLLIER, BANKRUPTCY ¶ 23.06(9), at 517 (14th ed. 1964).

In determining there was fraud the referee went beyond the limit for determination of summary jurisdiction. He erroneously thought he should hear all the evi-

dence. He considered the circumstances under which the security interest instruments were entered into to determine whether Armstrong's claim was valid. In finding fraud he made credibility decisions.[4] He went too far afield from the initial inquiry, which the cases contemplate, concerning summary jurisdiction. He fused the inquiry into his summary jurisdiction with a trial of the

---

[4] We need quote only part of the first of his forty "Conclusions":

> 1. Except to the extent that it is corroborated by credible witnesses or by documentary proof, the Court rejects as unworthy of credit the testimony of Armstrong's witnesses, Greenspan, Hirsch, Rubin, Spoleti and Fine for one or more of the following reasons: (1) their interest as officials or employees of Armstrong (with respect to all five); (2) their demeanor on the witness stand (with respect to Rubin, Spoleti and Fine); (3) the self-contradiction contained within their own testimony or documents previously prepared by them in connection with the transaction of December 14, 1961 (Greenspan, Hirsch and Rubin); (4) their evasive answers and their professed inability to recall significant facts likely to be documented and not likely to be easily forgotten (with respect to Greenspan, Hirsch and Rubin); (5) inherent improbabilities in their testimony (with respect to all five); (6) their contradiction by credible witnesses on behalf of the trustee who were without interest in the result of this litigation, including witness Roskin, a guarantor of the $2,500,000 loan who testified adversely to his interest (with respect to all five witnesses); and (7) the hesitating and backtracking manner of their testimony evidencing a lack of candor and a willingness to conceal information detrimental to Armstrong's case (with respect to Greenspan, Hirsch, Rubin and Spoleti).

The trustee recognized in his brief that: "The Referee credited Margolies' version of the discussions preceding the seizure and discredited the versions given by Rubin and Spoleti (A. 180, 182), upon which Armstrong's contentions are based."

merits. He concluded the inquiries simultaneously eight months after Armstrong undertook to show its adverse claim had substance.[5]

Whether a letter of Armstrong modifying the chattel mortgage by agreeing to fifteen day notice of default nullifies Armstrong's possession of the Manz chattels is a question for a plenary suit, as is the question of the propriety of its seizure of the Manz realty under the trust deed. The questions of the validity of the mortgage transactions in themselves, and of the validity and treatment of the underlying loans secured by the mortgages, having odors of fraud, may not be aired in the summary proceeding since the documents in themselves have appearances of honesty and arm's length dealing. And the truth of the testimony of Armstrong's officers is not for the referee in a preliminary inquiry into the substantiality of the adversity of the Armstrong claim.

It is no justification for the referee's exercise of summary jurisdiction to state that the adverse decisions relied on by Armstrong in support of its appeal are inapposite because they "involved an unlawful possession." This begs the question. Unless the security transactions on which Armstrong's claim rested show mere colorability on their faces, Armstrong was entitled to a plenary trial. See *In re Kansas City Journal-Post Co.*, 144 F.2d at 813-14. The testimony which Armstrong adduced in support of its claim should have been taken as true. *In re Goldstein*, 216 Fed. 887 (7th Cir. 1914).

---

[5] See note 3 *supra*.

We hold that the referee in bankruptcy, the bankruptcy court, was ousted of summary jurisdiction at that point where Armstrong's testimony, taken as true, and its exhibits, not merely colorable on their faces, showed prima facie a substantial claim; that the referee could proceed no further thereafter, 2 COLLIER, BANKRUPTCY ¶ 23.07[1], at 523-24 (14th ed. 1964); and that the trustee must be remitted to the ordinary court for plenary trial of its challenge to Armstrong's adverse claim.[6]

This holding is of course no barrier to the referee's summary disposition of claims with respect to property over which Armstrong took possession but which it obviously had no right to possess, *cf., Thompson* v. *Magnolia Co.*, 309 U.S. 478, 483 (1940), such as that explicitly excluded from Armstrong's chattel mortgage and that in which the bankrupt had but an equity under conditional

---

[6] The trustee filed a plenary suit in the district court in January, 1965, seeking to set aside the alleged fraudulent security transactions. This was done to toll the statute of limitations. Armstrong filed its answer in February of 1966, together with several counterclaims against the trustee and others. This is not pointed out to buttress this opinion in any way, but merely to show that the parties should be ready to proceed expeditiously in accordance with the mandate. It is unfortunate that the prolonged hearing must go largely for naught. This, however, is not Armstrong's fault. Had the referee dismissed the summary proceeding at the proper point, the ultimate settlement of the bankrupt estate would not have been postponed for so long a time. See comment of Judge Learned Hand in *Ford* v. *Magee*, 160 F.2d 457, 460 (2d Cir.), *cert. denied*, 332 U.S. 759 (1947). The early settlement of that estate ought to be the goal of the parties in framing the issues and of the district court in scheduling the plenary suit for trial.

sales contracts[7] made with the seventeen reclamation petitioners in this proceeding.[8]

The judgment of the district court is reversed. The cause is remanded with direction to dismiss the summary proceeding against Armstrong to the extent that this opinion holds that the trustee must be limited to a plenary suit against Armstrong.

---

[7] Several appellee briefs were filed in this court on this appeal on behalf of reclamation petitioners and general creditors, urging the affirmance of the court's judgment. We deem it unnecessary, in view of the result reached in our opinion, to treat separately the points made.

[8] As the district court held, 236 F. Supp. at 345:

> The Referee correctly ruled that by reason of the explicit exclusion of the inventory, work in process and raw materials from Armstrong's chattel mortgage, rendered any claim to possession of that property without any color of right. * * * Armstrong, likewise, had no basis to claim the substantial amount of third party property which is the subject matter of seventeen reclamation petitions filed in this proceeding.

No. 15086.

SWYGERT, *Circuit Judge*, dissenting:

If only because of the long and wasteful delay of a final disposition of this proceeding already incurred and now extended beyond prediction, it is unfortunate that this court's decision gives preference to form over substance.

On November 23, 1962 an involuntary petition in bankruptcy was filed against the bankrupt. Three days later a receiver was appointed and directed to take possession of Process-Manz' property. On April 1, 1963 the trustee's petition to sell the bankrupt's property came on for hearing before the referee. Eight months later, after thirty-three separate hearings (The record consists of some 3,000 pages of transcript and 125 written exhibits.), the referee ordered a sale to be held on February 11-15, 1964. The sale was stayed, however, upon Armstrong furnishing supersedeas bonds pending review. Now, more than three years after the debtor was adjudicated a bankrupt, this proceeding is back where it started in November 1962, and the trustee is faced with the task of adducing in a plenary suit the same evidence against Armstrong's asserted liens which was submitted to the referee and upon which it was found that the transaction of December 14, 1961, whereby the bankrupt executed to Armstrong a trust deed and a chattel mortgage covering its property in return for a loan of $2,500,000, was fraudulent as to creditors, and that Armstrong's claim should be subordinated to the claims of the other creditors. The district judge, after reviewing the evidence, affirmed the referee's determination, and in his opinion characterized Armstrong's conduct as "unfair, inequitable, unconscionable and fraudulent . . . in its transaction with Manz to the detriment and damage of its

creditors." *In re Process-Manz Press, Inc.*, 236 F. Supp. 332, 348 (N.D. Ill. 1964).

The referee properly exercised summary jurisdiction on two equally valid grounds.[1] First, Armstrong voluntarily submitted to summary jurisdiction by actively participating in the administrative phases of the proceeding. Armstrong appeared by counsel at the hearing before the referee on the motion for the appointment of a receiver on November 26, 1962. Its counsel also appeared before the district judge the next day when a petition to review the granting of the motion was considered. At that time Armstrong's attorney urged that the referee's appointment of a receiver be vacated and that the debtor be allowed to be in possession. On December 7, 1962 an order was entered by the referee with the consent of Armstrong's counsel which provided that the rights of Armstrong to possession and "questions of jurisdiction" be considered and determined as of the time of the filing of the involuntary petition in bankruptcy. This order was entered only after a suggested order was rejected by the referee which provided that Armstrong be restored to possession in the event the debtor was adjudicated a bankrupt and which Armstrong and the receiver had agreed upon. When the referee rejected the proposed order, Armstrong, rather than demanding that it be restored to the possession which it claimed, agreed to permit the receiver to continue in possession under the modified order.

Second, Armstrong's possession of the bankrupt's property between November 21 and November 27, 1962 was unlawful. Actual or constructive possession in the adverse

---

[1] The referee's findings and conclusions most pertinent to jurisdiction are included in an appendix to this dissent.

claimant is not alone sufficient to deprive the bankruptcy court of summary jurisdiction. As the Fifth Circuit said in *American Mannex Corp.* v. *Huffstutler,* 329 F.2d 449, 451 (5th Cir. 1964) (fn. 4), "Possession, actual or constructive, is . . . inconsequential. The important thing is the lawful, rightful character of that 'possession'." Here Armstrong without legal justification seized all the property of the bankrupt, including real estate, inventory (expressly excluded from Armstrong's chattel mortgage), and property which had been sold to the bankrupt by third parties on conditional sale. It is also significant that at the time of the seizure the bankrupt was merely the alter ego of Armstrong. (The referee found that by February 27, 1962 Armstrong had acquired one hundred per cent of the stock of Manz.) Courts of bankruptcy ought not be ousted of summary jurisdiction in these circumstances.

Armstrong's principal contention is that the referee should have conducted a preliminary hearing on summary jurisdiction and decided that question before attempting to proceed on the merits. The answer is that in the factual context of this case the questions of jurisdiction and the merits intertwine; in the words of Judge Learned Hand in *Buss* v. *Long Island Storage Warehouse Co.*, 64 F.2d 338, 339 (2d Cir. 1933), "the two coalesce."

Finally, Armstrong was not prejudiced either by the referee's failure to make a preliminary ruling with reference to jurisdiction or by his proceeding to hear the claim on its merits. Armstrong's attorney at all times understood that the referee was hearing the matter fully, reserving the question of jurisdiction. A full and complete hearing was conducted in which Armstrong participated and offered evidence. "Summary procedure fairly con-

ducted is not a denial of due process.'"[2] Armstrong's contentions that it was deprived of a jury trial and the right to implead third parties are afterthoughts and purely specious. The distinction between a summary hearing and a plenary suit in these circumstances is of no practical or substantive significance. This case ought not turn on the mere linguistic character of the distinction.[3]

In summary, I do not believe that Armstrong is entitled to relitigate issues that were fully heard and decided by the referee and affirmed by the district court. Recently the Supreme Court observed in *Katchen* v. *Landy,* 382 U.S. 323, 328 (1966), in which the exercise of summary jurisdiction was sustained, "this Court has long recognized that a chief purpose of the bankruptcy laws is 'to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period' . . . . "

I would adopt the reasoning of the district judge and affirm the judgment.

---

[2] *Shor* v. *McGregor,* 108 F.2d 421, 424 (5th Cir. 1939) (concurring opinion).

[3] In this connection the following observation of Judge Sanborn is pertinent:

> While such controversies over jurisdiction may be of some academic interest to the legal profession, they are profitless to litigants and wasteful of the assets of bankrupt states. Certainly something can be done toward making the jurisdiction of the courts of bankruptcy, with respect to such controversies, more definite and certain than it is at present.

Sanborn, *Committee Report to National Judicial Conference,* August 21, 1944, quoted in MACLACHLAN BANKRUPTCY § 195 n. 24 (1956).

APPENDIX TO DISSENTING OPINION

Portions of Referee's Findings and Conclusions

The Instalment Note for $2,500,000 dated December 14, 1961 contains two paragraphs on page 3 of said Note relating to the right of the holder of the Note to accelerate the indebtedness due on the occurrence of events of default. The first paragraph of the Note provides that in case of default of any payment of principal or interest, or other indebtedness owing by debtor, 15 days notice must be given before acceleration can be made. The paragraph which immediately follows provides that in the event of any default under the terms of the chattel mortgage or Deed of Trust securing the Note, acceleration may be made immediately. The provision of the chattel mortgage provides, among other things, that acceleration of the indebtedness not yet due may be made when the holder thereof deems the security unsafe and then it shall and may be lawful for the holder of the mortgage to enter and take possession of the mortgage chattels. On the same date, to-wit, December 14, 1961, as a condition of delivery of the Note, Chattel Mortgage and Trust Deed, Armstrong delivered to Manz a letter which stated as follows:

> "Reference is hereby made to the Instalment Note in the sum of $2,500,000 this date being executed by you and being delivered to us. . .
>
> With respect to the third paragraph on page 3 of said Note, which gives the holder the option, on the happening of default under the Chattel Mortgage or Trust Deed, to accelerate the principal sum owing, we do hereby agree with you that such option to accelerate the principal may be exercised by us only if said default continues for a period of fifteen (15) days after the sending of notice thereof to you by registered mail."

No notice was ever given by Armstrong to Manz.

* * * *

On November 26, 1962 Francis J. Curtis was appointed Receiver. Upon a review of the order appointing the Receiver, at a hearing before the Honorable William J. Campbell, Chief Judge of the United States District Court, Armstrong, through its attorney Harry Margolis, stated that his appearance was special on behalf of Armstrong, but addressed the Court at length in opposition to the appointment of a receiver and in support of the continued operation of the business of the Bankrupt by the Bankrupt as "debtor in possession." He stated:

> "We did not foreclose. We never intended to foreclose. We never intended to wipe out anybody's rights. It was always our intention to protect the unsecured creditors with any possible equity which would exist if the company continued to operate. . . . "
>
> "We informed them that in order to protect the assets for everybody, we were just going to take possession, because the debtor had talked about filing a Chapter XI, but did not get around to filing it, and the fact they didn't get around to filing it of necessity to protect everybody's interest, we took possession and said, 'Now, let us sit down and see how we can carry on the operation so that this thing can have continuity'."

He proposed that Armstrong finance the operation by the debtor at an interest rate of 7% per annum, which is the rate charged by Armstrong to the Receiver and Trustee during their operations. He further stated that the creditors were fully informed of the actions of Armstrong. This latter statement is not supported by the record, and the Court finds that creditors were not informed of Armstrong's intentions but that Armstrong's actions were contrary to the understanding and agreement reached be-

tween the Bankrupt, its creditors and Armstrong in the meeting of November 15, 1962.

On November 27, 1962 a conference was held between some of the creditors (at which counsel for the petitioning creditors was absent), counsel for the Receiver and counsel for Armstrong. At this meeting it was agreed that the Receiver would resume operation of the Bankrupt's business, that Armstrong would furnish funds for such operation and that the unfinished work in process would be completed. Armstrong agreed to advance $40,000 to the Receiver as a cost of administration and agreed to make further advances against receivables generated by the Receiver's operation. Armstrong agreed to withdraw the Pinkerton guards and on the evening of November 27, 1962 the guards were dismissed. Other agreements were also reached and all of the agreements were to be embodied in a petition and presented to the court for ratification and approval. The Receiver commenced operation of the business of the Bankrupt on the following day, November 28, 1962.

On December 6, 1962 a petition of the Receiver, jointly prepared by counsel for Armstrong and counsel for the Receiver, was presented to the Court for approval. It provided, inter alia, for an order approving the financing agreement between Armstrong and the Receiver which enabled the Receiver to resume operation of the business of the Bankrupt. It also provided that the use of the equipment and premises of the Bankrupt by the Receiver should be on condition that in the event of adjudication, the Receiver would be required to return the physical possession of the property to Armstrong. Provision for such return was likewise incorporated in an order. On December 6, 1962, upon presentation of the petition and

order, the Court rejected approval and ratification of the order, objecting to the provisions for delivery of the property to Armstrong on the happening of certain conditions and pointing out he was not bound by any agreement of the parties on this subject. At that time the Court offered to immediately hear the parties on any claim of adverse possession by Armstrong. On the afternoon of December 6, 1962 a conference was held between counsel for the Receiver, counsel for Armstrong, and the Referee. A new order was drafted based upon the petition previously presented and the agreement reached at the meeting with the Referee. This new order was presented to the Court on December 7, 1962. The new order, after further amendment, and by agreement with Armstrong's counsel, was signed by the Court. The new order provides for the rights of Armstrong to be determined as of the time of the filing of the petition in bankruptcy herein. The order, as signed, does not provide for the Receiver to deliver any of the property of the Bankrupt to Armstrong.

The Receiver continued to operate the business of the Bankrupt after November 28, 1962 on the basis of his financing agreement with Armstrong. The Bankrupt was unable to effect an arrangement with creditors. Its petition for an arrangement filed on November 26, 1962 was dismissed on January 31, 1963. An order of adjudication was entered on that date. On that same date Armstrong's counsel wrote a letter to the Receiver demanding possession of the premises and property of the Bankrupt in behalf of Armstrong. This demand was refused by the Receiver, who continued to operate the business until February 15, 1963 with financing furnished by Armstrong. On that date Francis J. Curtis was appointed Trustee. Armstrong objected to the Trustee's petition for leave to operate the business of the Bankrupt which was filed on February 20,

1963. On February 18, 1963 Armstrong in a letter to the Trustee agreed to his continued operation of the business and it continued until February 19, 1963, to furnish the finances for the operation of the business of the Bankrupt by the Trustee.

* * * *

The provisions of the letter of December 14, 1961 in modification of and delivered at the same time that the Note, Chattel Mortgage and Trust Deed were delivered, modified the printed provisions of the Chattel Mortgage instrument and also modified the third paragraph of the Instalment Note which appeared on page 3 of said Note and required Armstrong to give Manz fifteen (15) days notice by registered mail before it could accelerate the indebtedness which was not yet due and before it could take possession as provided for in said chattel mortgage instrument. In considering further, no such notice was given by Armstrong prior to the alleged taking of possession on November 21, 1962; that said possession so taken was in violation of the agreement made by Armstrong with Manz and that such alleged possession was illegal and of no effect as against the rights of the Trustee in bankruptcy herein.

* * * *

The claim of Armstrong to be considered in adverse possession of the premises and property of the Bankrupt by reason of the allegations in the petition of December 6, 1962, must be rejected on the basis of the record, which clearly discloses that the original proposed order presented to the Court for entry on December 6, 1962 containing the agreement relied upon by Armstrong was rejected by the Court, and a new order presented which eliminated that provision of the proposed order relied upon by Armstrong. That new order was signed by the Court on December 7, 1962 without objection by Armstrong, and by

agreement of its counsel, and its provisions must be regarded as controlling in the absence of any review. This order signed by the Court provides that Armstrong would be given the right to claim to be in adverse possession as of the time of the filing of the petition and this right was accorded to Armstrong by the Court.

Armstrong's claim to have been in adverse possession of the premises and property of the Bankrupt at the time of the filing of the involuntary petition herein must be considered in the light of the actual physical and exclusive possession by the Trustee and on the basis of the character of the property claimed by Armstrong to be in its possession. The real estate owned by the Bankrupt, which was transferred by the trust deed, is clearly not subject to foreclosure by a mere taking possession but requires foreclosure proceedings in a court of law. Smith-Hurd Illinois Statutes. Ch. 95, par. 23, prohibits a power of sale in a real estate mortgage. No such power is contained in the trust deed in question. The remedy provided in the trust deed is by way of foreclosure in a court. The real estate of the Bankrupt is accordingly within the summary jurisdiction of this Court, and not subject to Armstrong's claim of adverse possession.

The chattel mortgage specifically excludes from its provisions, inventory and work in process, which are of substantial value in this case. Such property cannot be, and is not, subject to Armstrong's claim of adverse possession. There likewise appears to be a very substantial amount of machinery and equipment on the premises which is not included in the chattel mortgage of Armstrong.

Another substantial amount of property contained in the premises of the Bankrupt consists of third party property. Seventeen claimants filed reclamation petitions as-

serting that they had sold specific equipment to Manz either under conditional sales contracts or secured by chattel mortgages. As to those items sold under conditional sales agreements, Armstrong has no color of right or claim. Such property is within the summary jurisdiction of the Court.

A further category of property of the Bankrupt which is clearly not subject to Armstrong's claim of adverse possession is the substantial amount of accounts receivable which were financed upon a non-notification basis, collected by the Bankrupt and remitted to the finance company. Such accounts receivable are within the summary jurisdiction of this Court.

Armstrong's active participation in the proceeding such as the statement of its counsel, Harry Margolis, to the District Court on November 27, 1962, objecting to the appointment of a receiver and proposing operation by a debtor-in-possession and Armstrong's arranging for the filing of the Chapter XI proceedings by offering to pay the fee of counsel for the debtor coupled with Armstrong's negotiations with creditors prior to the Order of Adjudication regarding a Plan of Arrangement and an offer of settlement to creditors, constitutes Armstrong a party to the proceedings in like manner as if a general appearance were filed. Armstrong's submission of evidence on the hearings which went beyond actual proof of its mortgage indebtedness and possession likewise constitutes a submission to the jurisdiction of the Court.

Armstrong's claim to be considered to be in adverse possession of the premises and property of the debtor must be considered in the light of the record disclosing its acts and doings on November 21, 1962 in posting guards at the main entrance and in locking all outer doors to the Manz

building. The Manz building occupied in excess of one-half of a square city block. There was no identification, segregation or tagging of the machinery and equipment or personal property located on the many floors within the plant included in Armstrong's chattel mortgage. The acts of Armstrong in attempting to take possession, as stated above, consisted merely in posting guards at the entrance of the plant and in changing locks to numerous doors to the plant. By such grab-law tactics Armstrong claims possession of the entire building, which contained the property of six tenants, the free property not covered by its mortgages and the third party property likewise not covered by the mortgage. Armstrong's agents did not have the chattel mortgage with them on November 21, 1962, the date of the purported taking of possession, in order to identify the property included in the mortgage. No notice of sale or inventory was posted; the signs put up merely stated that Armstrong was taking possession of the premises and machinery, equipment and personal property in the plant. Armstrong's acts and doings of November 21, 1963 were not sufficient to constitute taking of possession of the property described or included in its mortgage located within the Manz plant sufficient to oust the Bankruptcy Court of summary jurisdiction over such property of the Bankrupt.

Armstrong's claim to exclusive possession is not substantiated and is clearly contradicted by the record, which discloses the following: (a) the presence of six tenants and their employees and (b) the presence of the Bankrupt's employees, including Myron Laden, the office personnel, the maintenance men, engineers, guards with uniforms containing the Manz name. All of these employees were present in the plant at various times, performing their regular duties, in the employ of the Bankrupt. The

operation of the bindery department on November 23, 1962 and the shipment of the Allen Lithographing job for Jewel Tea Co. and Pabst Co. on the night of the same day renders Armstrong's claim to exclusive possession clearly untenable. Armstrong sent $30,000 to the Bankrupt on Friday, November 23, 1962. Myron Laden assigned an account receivable on November 22, 1962 to Armstrong after the time of its claimed possession. Armstrong's possession was clearly not exclusive, but ambiguous, and in such case any doubt must be resolved against the mortgagee and in favor of the mortgagor's possession. Such possession of the mortgagor would pass to the Trustee by operation of law as of the time of the involuntary petition filed on November 23, 1962.

Armstrong's claim to adverse possession must also be considered in the light of the record of its relationship with the Bankrupt which was not that of an ordinary borrower and secured lender on an "arms-length" basis. Armstrong had complete control over all income of the Bankrupt, held all of the capital stock of the Bankrupt, with blank endorsements, under the terms of a loan with which the Bankrupt could not comply. These factors, together with the absence of any control or direction by the Board of Directors or the shareholders of Manz, coupled with the control over the purse strings of the Bankrupt by Armstrong, placed it in the position of a principal and the Bankrupt in the position of its agent. The purported taking of possession by Armstrong was in fact, the act of a principal, taking its own property into its possession, in an illegal attempt to prevent the administration of the assets of the Bankrupt by the bankruptcy court. Armstrong's attempt to take possession on November 21, 1962, a few days after making commitments to the

creditors on November 15, 1962, at the meeting of creditors on that date and in violation thereof, together with Armstrong's decision that it would first take possession before the filing of a Chapter XI proceeding by the debtor and its threat to cut off all finances if the Bankrupt filed a Chapter XI proceeding before Armstrong could take possession (testified to by Michael Margolies), constitutes a fraud on creditors and on the Bankruptcy Act such as to require denial of its claim to adverse possession.

Armstrong's claims to adverse possession must also be considered in the light of the status of the bankruptcy proceeding at the time of the filing of its motion claiming adverse possession on February 14, 1963. This Court offered to adjudicate the controversy over possession at the commencement of these proceedings in early December, 1962. That offer was rejected by Armstrong. Thereafter Armstrong made possible the Receiver's resuming the operation of the business of the Bankrupt by providing the necessary financing. Such funds were continued to be furnished not only to the Receiver, but to the Trustee after the Order of Adjudication on January 31, 1963, and after the motion of Armstrong was filed on February 14, 1963. During the pendency of these proceedings numerous reclamation petitions were filed. General unsecured claims in excess of One Million Dollars have been filed. Wage claims in excess of $40,000 have been filed. Tax claims of approximately $140,000 have been filed, including a claim by the United States of America in the sum of $107,000. All of these claims have been filed in accordance with the provisions of the Bankruptcy Act on the basis that this Bankruptcy Court was administering the assets of the Bankrupt in the usual and normal bankruptcy administration. The rights of all of the foregoing third parties have become affected to such a point that it would constitute a

gross miscarriage of justice to recognize at this late stage in these proceedings the claim of Armstrong to the right of adverse possession. Recognition of that claim would require the Court to simply turn over all of the property in this estate to Armstrong. The rights of these third parties are additional grounds for this Court to retain jurisdiction to administer all of the property of the Bankrupt.

Armstrong's claim to adverse possession is essentially a claim to the right to administer all of the assets and property of the Bankrupt estate located within the Bankrupt's plant, free of interference by the Bankruptcy Court. It is an illegal attempt to take over a going business, including assets not covered by its mortgages and which it had no legal right to take into its possession. The purported possession of Armstrong of the premises and property of the Bankrupt is inferior to the paramount right of this Bankruptcy Court to administer all of the assets of the Bankrupt for the benefit of all creditors of the estate.

Armstrong has failed to sustain the burden of proof of its allegations in its motion that it is, or was, prior to bankruptcy, in adverse possession of the premises, machinery, fixtures, equipment or personal property of Manz, the Bankrupt herein.

A true Copy:
Teste:

.....

Clerk of the United States Court of Appeals for the Seventh Circuit.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60610

Friday, July 29, 1966

Before

Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. ROGER J. KILEY, Circuit Judge
Hon. LUTHER M. SWYGERT, Circuit Judge

In the Matter of Process-Manz Press, Inc., Bankrupt. A. J. ARMSTRONG CO., INC., Appellant, No. 15086 vs. EDWARD LIMPERIS, Successor Trustee, MIEHLE-GOSS-DEXTER, INCORPORATED, et al., Appellees.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, and that this cause be, and it is hereby, REMANDED to the said District Court in accordance with the opinion of this Court filed this day.

It is further ordered and adjudged that the costs on this appeal be taxed in favor of appellant, A. J. Armstrong Co., Inc., and against appellee Edward Limperis, Successor Trustee.

APPENDIX D

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

Monday, October 3, 1966

Before

Hon. JOHN S. HASTINGS, Chief Judge
Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. WIN G. KNOCH, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge
Hon. ROGER J. KILEY, Circuit Judge
Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. THOMAS E. FAIRCHILD, Circuit Judge
Hon. WALTER J. CUMMINGS, JR., Circuit Judge

In the Matter of Process-Manz Press, Inc., Bankrupt.

A. J. ARMSTRONG CO., INC., Appellant,

No. 15086 vs.

EDWARD LIMPERIS, Successor Trustee, et al., Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED by the Court, *en banc*, that the petition of appellee Edward Limperis, Successor Trustee, for rehearing *en banc*, be, and the same is hereby DENIED. (Swygert, C.J. voted to grant the petition for rehearing *en banc*).

APPENDIX E

UNITED STATES DISTRICT COURT.

(Caption—62-B-9414)

MEMORANDUM AND ORDER.

Campbell, C. J.

This matter is before me on the petition of A. J. Armstrong Co., Inc. (hereinafter referred to as Armstrong), seeking review of two orders entered by the referee, one on November 27, 1963, and the other on December 2, 1963. The order of November 27 (1) overruled the motion of Armstrong challenging the summary jurisdiction of the Court; (2) invalidated a chattel mortgage and trust deed executed as part of a transaction entered into on December 14, 1961 by Armstrong and the bankrupt securing a loan of $2,500,000; (3) subordinated the claim of Armstrong (asserted to exceed $3,750,000) to the claims of all general creditors herein filed and allowed (in an approximate amount of $1,181,000); and (4) directed a sale of all of the assets of the bankrupt free and clear of the liens asserted by Armstrong. The order of December 2, implemented the sale portion of the order of November 27, by fixing the date of sale and by authorizing the trustee to employ an auctioneer to sell the assets. The dates set for the sale were February 11 through February 16, 1964. The sale was not held, however, by reason of the objection of Armstrong thereto and by the compliance by Armstrong with conditions of stay of said orders imposed by the referee and affirmed, in turn, by this Court and the Court of Appeals. The stay conditions were that Armstrong post two corporate surety bonds totaling $3,000,000, one in the amount of $2,000,000, securing the trustee and the unsecured creditors herein, and one in the amount of

$1,000,000, securing the reclamation petitioners claiming under conditional sales contracts or leases. The corporate surety bonds were posted by Armstrong on February 7 1964, three days before the first sale date.

The key order under review is, therefore, the order of November 27, 1963. This order containing detailed findings and conclusions of the Referee, is 66-pages and was entered after many months of hearings before the Referee. Both the trustees and Armstrong filed lengthy briefs before the Referee prior to the entry of this order, and both parties have likewise filed lengthy, detailed briefs before me. I have just concluded my review of the orders of the Referee under challenge, the pleadings, the transcript of the testimony and the exhibits upon which the orders were based, the petition for review by Armstrong and the briefs of the parties.

Armstrong's contentions here are basically the same as they were before the Referee, namely, that the Court does not have summary jurisdiction to adjudicate the claim of Armstrong on the merits. In addition, Armstrong now asserts that the findings of the Referee are not supported by competent evidence in the record. Armstrong also asserts that the Referee should have made additional or contrary findings upon the conflicting evidence before him. Armstrong also contests the order of the Referee on the merits, i.e., the holding that the transfers of December 14, 1961, were fraudulent conveyances under Sections 67d and 70e of the Bankruptcy Act and the holding that Armstrong's entire claim should be subordinated to the claims of all general creditors filed and allowed herein.

A review of the pertinent facts necessary for an understanding of the legal issues is hereinafter set forth.

The Key Participants.

The three key participants involved are Process-Manz Press, Inc., the bankrupt; Process Lithographers, Inc., and A. J. Armstrong Co., Inc.

Process-Manz Press, Inc. (hereinafter referred to as "Manz" or "the bankrupt") was engaged in the printing business and had been so for approximately 90 years. It occupied a large building situated on more than one-half of a city block in Chicago at the date of bankruptcy. November 23, 1962. It had formerly been known as Manz Corporation but had changed its name to Process-Manz Press, Inc. in May, 1962.

Process Lithographers, Inc. (hereinafter referred to as "Lithographers"), is a New York corporation which was engaged in the printing business in New York City. It has now been adjudicated a bankrupt in New York.

Armstrong is engaged in the finance business in New York. It is successor to City Industrial Company, a partnership formerly engaged in the finance business.

The Contract of March 20, 1961 for the Sale of the Major Part of the Manz Stock.

On March 20, 1961 the three principal shareholders of the bankrupt, Morrie Moss, Lester Neumann and Louis Kessler, owners of in excess of 91% of the stock of Manz, entered into a written contract for the sale of all of their stock, both preferred and common, to Lithographers. The contract provided for payment without interest of the sum of $2,236,083.04 to the three principal shareholders in monthly installments over a period of four years from the date of the contract, with two exceptions: (1) Kessler was to be paid in full by October 15, 1961; (2) Neumann was

to receive a substantial payment on account ($172,833.33) on August 1, 1961. The contract provided for all of the then officers and directors of Manz to resign. They did so resign and new officers and directors were elected by Lithographers on or about March 20, 1961.

Lithographers immediately on March 20, 1961 assumed full ownership and control of Manz, subject to a restriction against the sale or hypothecation of the assets of Manz stipulated in the contract. The restriction, in effect, prohibited the sale or hypothecation of the assets of the bankrupt unless one-half of the proceeds of the sale or loan were paid to the selling shareholders in part pre-payment of the sale price of their stock.

The new officers of the bankrupt were the same as the officers of Lithographers, and to all intents and purposes Lithographers was the parent of the bankrupt. The contract of March 20, 1961 vested full voting rights of shareholders in Lithographers.

Monthly payments as provided in the contract were made by Lithographers to the shareholders until August 1, 1961. At this time and prior thereto, Lithographers was in financial difficulty and was not paying its debts in the regular course of business. It was unable to pay the full installment of $172,833.33 due to Neumann on August 1, 1961 and paid only $50,000 on account. The balance of this installment was not paid to Neumann until October 16, 1961.

The Loan of October 4, 1961.

On October 4, 1961 the new officers of Manz (Roskin and Young) entered into an agreement with Armstrong for a secured loan of $1,000,000 in behalf of Manz. Of this, $500,000 was to be advanced to Manz, and $500,000 was to be held by the lender in escrow pursuant to special

permission granted by two of the selling shareholders (Neumann and Moss) for the mortgaging of the assets of the bankrupt. The $500,000 withheld was to be turned over to the selling shareholders by Armstrong in the event of nonpayment of the loan by a designated date.

From the proceeds of the loan of $500,000, the bankrupt advanced $289,231.75 to Lithographers, which the latter used to pay the balance due to Neumann in the sum of $122,833.33 for the installment of August 1, 1961.

Negotiations With Armstrong for $2,500,000 Loan.

After the loan of October 1, 1961 negotiations were conducted between Armstrong and the bankrupt for a loan of approximately $2,500,000 to be made upon the property of the bankrupt. During said negotiatins Armstrong required as conditions to the making of the loan (1) 100% of the shares of stock of Manz to be deposited with it as collateral; and (2) an exclusive contract for all of the accounts receivable financing, which would continue in effect so long as the bankrupt was indebted to Armstrong.

On October 31, 1961 the bankrupt signed a contract for the assignment of all of its accounts receivable to Armstrong. Under this arrangement Armstrong received copies of all invoices and received all the income generated by Manz and in return made advances to Manz in amounts solely determined by Armstrong.

On November 6, 1961 Manz, Lithographers and Armstrong entered into a written agreement whereby Lithographers assigned to Armstrong all of its interest in and to the contract of March 20, 1961 with the selling shareholders of Manz as collateral for the proposed loan. On November 6, all shares of stock of Manz paid for and acquired by that date were delivered to Armstrong by

Lithographers. Armstrong thereby acquired all the interest and rights of Lithographers under the contract of March 20, 1961 and in the shares of stock of Manz covered by that contract. Armstrong also acquired the right to make the payments due on the contract of March 20 in the event of any default by Lithographers.

The Loan of December 14, 1961.

On December 14, 1961 Manz executed and delivered to Armstrong a trust deed transferring its real estate, a chattel mortgage transferring certain of its personal property (exclusive of inventory and work-in-progress) and a promissory note for $2,500,000 with interest at 12% annum.

In consideration of these transfers and the delivery of the promissory note, Armstrong on the same date disbursed the proceeds of the $2,500,000 loan as follows: (1) it repaid itself the sum of $500,000 borrowed from it by Manz on October 4, and released to itself the balance of that loan held in escrow pursuant to the loan agreement; (2) it paid itself $11,666.67 in interest on the loan of October 4; (3) it paid $2,525 to Melvin Hirsch, its Vice President and General Counsel, for title expenses and attorney's fees; (4) it delivered two checks—one for $814,432.58 and one for $624,122.49, or a total of $1,438,555.07—payable to the order of Schwartz, Nathanson and Frank, attorneys for Manz, to George Schwartz; and (5) it issued a check for $547,253.26, payable to Manz (representing the net cash proceeds actually received by Manz). The two checks delivered to Schwartz were delivered with directions and on condition stipulated by Armstrong that the amount of the first check be paid over to Moss and the amount of the second check be paid over to Neumann to prepay to Moss and Neumann the respective total balances due to

them on the contract of arch 20, 1961 and that George Schwartz receive in return from Moss and Neumann (or their escrow agent) the balance of the shares of stock of Manz, covered by these payments and deliver them to Armstrong as collateral for its loan in accordance with the terms of the loan.

Upon receipt of the two checks Schwartz exchanged them for two certified checks in amounts identical thereto, payable respectively to Moss and Neumann. Schwartz then delivered these certified checks to Moss and Neumann from whom he had already obtained the remaining balance of stock (both preferred and common) and for whom he was acting as escrow agent. Schwartz then certified to Armstrong that he had "this day made payment to the selling shareholders under the agreement of March 20, 1961 of the sums which we computed to be the balance provided for under said agreement," and further, that in his opinion, "there is no prohibition or restriction of any nature under the terms of said agreement which would prevent Manz * * * from mortgaging its assets or assigning its accounts receivable." Schwartz delivered to Armstrong the shares of Manz stock which he had received from Moss and Neumann. These shares were, as were all other shares of Manz stock previously delivered to Armstrong, endorsed in blank with blank signed powers of attorney. Of the net cash proceeds of the loan actually received by it—$547,000—Manz transferred $200,000 to Lithographers.

On December 14, 1961 several creditors of Manz had claims against Manz which have never been paid and are still due and owing.

Stock Redemption

On December 5, 1961 Melvin Hirsch, Vice President and General Counsel of Armstrong, arranged with local counsel for Armstrong in Chicago, for the Articles of Incorporation of Manz to be amended so as to authorize the redemption of preferred stock (Trustee's Ex. 87). Said authorization was given by the officers of the bankrupt at the direction of Armstrong. At the same time, counsel for Armstrong drafted a statement of redemption and cancellation of 282,000 shares of preferred stock. This statement was signed on December 22, 1961 and filed with the Secretary of State of Illinois on December 29, 1961 at the direction of Armstrong. The Certificate of Redemption reflects the amount of $1,979,640 paid by Manz to Lithographers for these shares. The books of Manz, however, show the transaction as follows: Manz redeemed 282,000 shares of its preferred stock from Lithographers at $7.23 per share or a total of $2,038,860. The bankrupt subsequently made a correcting entry of $59,220 on its books to adjust the redemption price down to $7.02 per share. This made the final redemption price for the 282,000 shares $1,979,640. Of this amount $1,438,555.07 represents the amount paid to Moss and Neumann. This amount was treated as an advance to Lithographers. The difference between the two amounts—$541,084.93—was credited to the cancellation of indebtedness owing to Manz in an equivalent amount by Lithographers for cash advances made to Lithographers and for printing jobs done by Manz for the account of Lithographers.

Financial Condition of Bankrupt Before and After the Commencement of its Relationship With Armstrong.

Prior to its dealings with Armstrong, Manz had no mortgages on any of its property except for balances due

on conditional sales contracts for purchase of specific items of property. Manz did not discount its accounts receivable but relied entirely upon bank financing at the usual and customary rates charged by banks. The annual volume of Manz' business was $6,000,000. However, since January, 1961 Manz had been slow in paying its bills to trade creditors. Moreover, it had sustained losses in the calendar years 1958 through 1960 inclusive. The combined amount of the loss in 1959 and 1960 was $468,953.21.

The obligations of Manz to its unsecured creditors on December 14, 1961 were approximately $588,000.

Following the transaction of December 14, 1961 the financial condition of Manz grew progressively worse from month to month. Within 11 months from that date, accounts payable, exclusive of taxes, wages and indebtedness to Armstrong, aggregated approximately $1,181,000. Within 30 days from the date of the loan, Manz was in default among other reasons by its failure to maintain the required ratio of net working capital of a minimum of $400,000 and by its failure to maintain a minimum net worth of $1,300,000 as required by the loan agreement. Additional defaults under the loan agreement thereafter accrued. Manz made payments on the loan in March, April and May, 1962 and defaulted entirely on the payment due in June, 1962.

Armstrong made advances to Manz on accounts receivable in round figures without reference to the accounts receivable financial contract of October 31, 1961. The contract which provided originally for a 70% advance was amended on December 14, 1961 to provide for an 80% advance. During the early months under the contract Armstrong advanced substantially less than the agreed percentage, while in the later months Armstrong advanced

substantially in excess of the agreed percentage. Manz assigned to Armstrong all of its receivables, including rents from tenants and miscellaneous claims. Included in the miscellaneous claims was a claim for an inventory adjustment (against the selling shareholders) which Armstrong learned about at the last moment, and in the language of its Vice President and General Counsel, "grabbed, in its usual course of grabbing everything." Manz was thereafter dependent solely upon Armstrong for its financial needs and Armstrong supplied to Manz the funds required for payroll and other expenses of operation (including Federal Withholding Tax payments to the District Director of Internal Revenue) as Armstrong deemed it necessary.

Armstrong's Knowledge of the Financial Condition of Manz Both Before and After the Loans of December 14, 1961.

Armstrong had knowledge of the financial condition of Manz prior to the loan of December 14, 1961 by reason of its examinations of Manz' books and records by its examiners and by conversations its examiners had with the Controller and other personnel of Manz.

Armstrong had continuous knowledge from October, 1961 to the date of bankruptcy (November 23, 1962) of the inability of Manz to pay its debts, in the regular course of business as they matured. During all of this period Armstrong was constantly and fully informed of the pressure brought by creditors of Manz for the payment of their debts.

Events Preceding Bankruptcy.

During the period from June to November, 1962, while Margolies and Fund, president and treasurer, respectively, of Manz were keeping Armstrong fully informed of the

continually worsening financial condition of the bankrupt and of the continual pressure by creditors for payment, efforts were being made to effect a sale and leaseback of the Manz real estate. A portion of the proceeds of this anticipated sale and lease-back were to be used to pay creditors a proportionate part of their claims. Margolies and Fund kept Armstrong fully advised of the progress in the negotiations for the sale and lease-back. These negotiations were still pending and a deposit of $65,000 in connection therewith was still being held by attorneys for Manz in New York at the time of the bankruptcy. One of the features of the sale and lease-back was that in the event of a default by Manz thereunder, Armstrong was to have the privilege of leasing the Manz plant for one year.

On November 9, 1962 Margolies proposed to Greenspan at a conference at Armstrong's offices in New York that a meeting of the larger creditors be convened to discuss the agreement for the proposed sale and lease-back of the real estate and to determine what amount the larger creditors would accept as part payment of their account. Greenspan at first questioned the advisability of calling creditors together and "telling each of them in essence what we owed to the other one because they might realize that we owed them a considerable sum of money" and that "it might worry them." Greenspan, however, ultimately agreed, and on the following November 15, a meeting of the ten largest creditors was held on the premises of the bankrupt. Rubin, Vice President of Armstrong, was also present. At this meeting officers of the bankrupt, creditors and Rubin discussed the proposed sale and lease-back of the real estate of Manz to the Walter J. Schneider Corporation. The sale and lease-back would have required the release of the trust deed by Armstrong and the division

of the proceeds of the sale between the creditors as a group and Armstrong. The financial condition of Manz was also a subject of discussion. Creditors were offered participation to the extent of $.10 on the dollar for their claims and some debenture bonds to be issued by Schneider. Rubin made no objection at the meeting to this proposal on behalf of Armstrong and agreed to accept $750,000 for a release of the trust deed on the real estate of Manz.

Four days following the meeting of November 15, or on November 19, 1962, at a conference in the offices of Armstrong in New York, Rubin told Margolies "that after reconsidering the offer that had been made to the creditors the previous Thursday that Armstrong had changed their minds, that they felt we were giving too much to the creditors and that they could not go along with the deal as we had outlined it."

On November 20, the following day, Rubin told Margolies at a conference in the offices of Armstrong in New York:

> "that the way we must proceed now in the light of not going ahead with the creditors, giving them the money from the sale and leaseback, was that Armstrong wanted to take possession of the plant; that the company could then file a Chapter XI proceeding; that when the Chapter XI was filed, that Armstrong would give back the plant one day later. We could then continue to operate the plant and this would give Armstrong the protection that in case the Chapter XI failed for any reason that possession of the plant would revert back to Armstrong."

Margolies objected and requested time to consult an attorney to consider the proposal made by Rubin and also to consider the immediate filing of a voluntary proceeding under Chapter XI of the Bankruptcy Act. To this sug-

gestion Rubin replied that if such proceeding were filed by the bankrupt, Armstrong would withhold all financial assistance, but if Armstrong were permitted first to take possession of the property of the bankrupt, the bankrupt could thereafter file its Chapter XI proceeding and Armstrong would surrender possession to the debtor and lend its aid to its financial rehabilitation.

Armstrong's Activity on November 21-27, 1962 With Respect to the Manz Plant.

On November 21, 1962 Armstrong sents its representatives, Spoleti and Fine, to the Manz plant and informed the employees of the Manz plant that Armstrong was taking possession of the Manz premises, machinery, equipment and personal property. The locks on the outer doors were changed by a locksmith employed by Armstrong. A number of signs were posted on the building stating as follows:

> "Possession of these premises and the plant machinery, fixtures, equipment, and personal property of Process-Manz Press, Inc., located and contained herein, is exclusively held by A. J. Armstrong Co., Inc., 850 Third Avenue, New York City, New York, Plaza 2-5300."

Pinkerton guards were employed to police the main entrance to the Manz plant and to patrol the outer premises at periodic intervals. The Manz plant contained six tenants. Four of the tenants had self-contained operations behind closed doors and none of the premises of these tenants was occupied by the guards. Two of the tenants occupied space accessible only through the Manz premises. All these tenants continued to occupy their space and operate their business continuously from November 21, 1962 through November 27, 1962. Employees of Manz finished

their day's work on November 21, 1962. Myron Laden, the Manz guards, the maintenance men and the engineers continued to work in the Manz plant, in the employ of Manz, performing their usual duties from November 21 to November 27, 1962. These employees were not hired by Armstrong.

The chief function of the guards employed by Armstrong was to remain at the main entrance of the Manz plant and to admit to the premises persons designated upon a list of names and to occasionally police the outer premises. The list of names included the tenants and their employees and the Manz employees who were to be admitted into the premises. On Friday, November 23, 1962, the bindery department of Manz was operated and approximately 24 employees of Manz worked that day. The orders on which they worked were shipped that night. On the same day Armstrong advanced approximately $30,000 to Manz by way of a deposit into its bank account. Two Manz' employees, Virgil Lynch and William Hagen, whose names were not on the Armstrong list, were in the Manz plant on November 23, 1962 without the permission of Armstrong.

The Required Notice of Default.

The Installment Note of December 14, 1961 for $2,500,000 contains two paragraphs on page 3 thereof, relating to the right of the holder to accelerate the indebtedness on the occurrence of a default. The first of the two paragraphs provides that in case of default in any payment of principal or interest, or any other indebtedness owing by the debtor, fifteen days notice must be given before acceleration can be made. The immediately following paragraph provides that in the event of any default un-

der the terms of the Chattel Mortgage or Trust Deed securing the note, acceleration, may be made immediately. The chattel mortgage provides that acceleration of the indebtedness not yet due may be made when the holder deems the security unsafe and then it shall be lawful for the holder of the mortgage to enter and take possession of the mortgaged chattels.

On the same date that the note was executed, December 14, 1961, Armstrong delivered to Manz a letter which stated as follows:

> "Reference is hereby made to the Installment Note in the sum of $2,500,000 this date being executed by you and being delivered to us.
>
> "With respect to the third paragraph on page 3 of said Note, which gives the holder the option, on the happening of default under the Chattel Mortgage or Trust Deed, to accelerate the principal sum owing, we do hereby agree with you that such option to accelerate the principal may be exercised by us only if said default continue for a period of fifteen (15) days after the sending of notice thereof to you by registered mail."

No such notice as required by either paragraph was ever given by Armstrong to Manz.

The Filing of the Bankruptcy Petition and Events Thereafter.

On Friday, November 23, 1962 at 12:45 P. M., an involuntary petition in bankruptcy was filed against Manz. The same afternoon a petition for the appointment of a receiver was served on Manz and notice of that petition was given to Armstrong.

On November 25, 1962 a meeting was held between several of the principal creditors of Manz, the attorneys for

the petitioning creditors and Armstrong (represented by Greenspan, Rubin and Harry Margolis). No officer, shareholder or other representative of Manz was present at the meeting. Harry Margolis addressed everyone and stated, "I still think this situation can be worked out with some good management, and I don't see any reason that you have to have a receiver appointed." To this the attorney for the petitioning creditors replied, "If we are talking about new management, shouldn't we have the debtor here?" Margolis replied:

> "What are you worried about the debtor for? . . . we can supply you with any debtor . . . we have 90 or 92% of the stock and we can control the situation."

With respect to new management, Rubin had telephoned Neumann, the former stockholder and officer of Manz, in late October or early November, 1962 at Neumann's home in Miami, and told Neumann that if he "desired to reenter the picture," he "could do so as president."

A few days after the bankruptcy petition was filed, Rubin agreed with Michael Margolies (president of Manz) to pay the fee of the attorneys representing Manz in the Chapter XI proceedings filed by Manz herein. On November 26, 1962 the referee appointed Francis J. Curtis receiver. Upon a review of the order appointing Curtis, at a hearing the next day before me, Armstrong, through its attorney Harry Margolis (who stated that his appearance was special on behalf of Armstrong), addressed the court at length in objection to the appointment of a receiver and in support of the continued operation of the business of Manz by Manz as a debtor. Margolis stated on this occasion as follows:

> "We did not foreclose. We never intended to foreclose. We never intended to wipe out anybody's rights. It was always our intention to protect the

> unsecured creditors with any possible equity which would exist if the company continued to operate . . .'' ''We informed them that in order to protect the assets for everybody, we were just going to take possession, because the debtor had talked about filing a Chapter XI, but did not get around to filing it, and the fact they didn't get around to filing it of necessity to protect everybody's interest, we took possession and said, 'Now, let us sit down and see how we can carry on the operation so that this thing can have continuity.' ''

Margolis also proposed that Armstrong finance the operation by the debtor at an interest rate of 7% per annum in lieu of the 12% rate charged Manz. At the conclusion of the oral arguments on the petition for review I affirmed the order of the referee appointing a receiver. Later the same day, November 27, a conference was held between some of the creditors, counsel for the receiver and counsel for Armstrong. At this meeting it was agreed that the receiver would resume operation of Manz' business, that Armstrong would furnish funds for this operation and that the unfinished work in process would be completed. Armstrong agreed to advance $40,000 to the receiver as a cost of administration and agreed to make further advances against receivables generated by the receiver's operation. Armstrong agreed to withdraw the Pinkerton guards, and that evening (November 27, 1962) the guards were dismissed, and the receiver, whose appointment was affirmed that day, took over the Manz property. Other agreements were also reached and all the agreements were to be embodied in a petition to be presented to the court for ratification and approval. The receiver commenced operation of the business of Manz on the following day, November 28, 1962.

On December 6, 1962, a petition of the receiver was presented to the court for approval. It provided, among other things, for an order approving the financing agreement between Armstrong and the receiver which enabled the receiver to resume operation of the business of Manz. It also provided that in the event of adjudication the receiver would be required to return the physical possession of Manz' property to Armstrong. Provision for such return was likewise incorporated in a suggested order. On December 6, 1962, upon presentation of the petition (which contained a paragraph making all of the agreements described therein subject to ratification by the court), the court rejected approval of the petition and order, objecting to the provisions for delivery of possession of the property of Manz to Armstrong on the occurrence of certain conditions described in the petition and order. The referee pointed out that he was not bound by any agreement of the parties on this subject. At that time the court offered immediately to hear the parties on any claim of adverse possession by Armstrong. Armstrong declined this offer.

On the afternoon of December 6, 1962 a conference was held between counsel for the receiver, counsl for Armstrong and the referee. This conference was initiated by Armstrong. A new order was drafted based upon the petition previously presented and the agreement reached at the meeting with the referee. This new order was presented to the court on the following day, December 7, 1962. The new order after further amendment, and by agreement with Armstrong's counsel, was signed by the referee. The new order provided that the rights of Armstrong be determined as of the time of the filing of the petition in bankruptcy. The order further eliminated the provision

for the receiver to deliver any of the property of Manz to Armstrong.

The receiver continued to operate the business of Manz after November 28, 1962 on the basis of the financing agreement with Armstrong. Manz after filing a petition for the arrangement under Chapter XI and obtaining approval of the petition by the referee, was then unable to effect an arrangement with creditors. A petition for arrangement filed on November 26, 1962 was dismissed on January 31, 1963 and an order of adjudication was entered on that date. On the same day, Armstrong's counsel wrote a letter to the receiver demanding possession of the premises and property of Manz in behalf of Armstrong (on the basis of the petition of December 6), and this demand was refused by the receiver who continued to operate the business until February 15, 1963 with financing continued to be furnished by Armstrong. On that date, Francis J. Curtis was appointed trustee. On February 18, 1963 Armstrong in a letter to the trustee agreed to his continued operation of the business and it continued until February 19, 1963 to furnish the finances for the operation of the business of Manz by the trustee.

In the course of this proceeding seventeen reclamation petitions were filed. The reclamation petitions seek recovery of property sold by the petitioners to Manz under conditional sale (or title retention agreements) or leased to Manz.

In addition, some $1,100,000 in claims have been filed by general creditors; the Director of Internal Revenue has filed a claim for some $107,000 for withholding taxes; and a number of claims have been filed by other governmental agencies for taxes due from the bankrupt. Some $50,000 in wage claims have also been filed. All of these claims

were filed in accordance with the applicable provisions of the Bankruptcy Act.

Armstrong contests the summary jurisdiction of the court and contends that the Referee should have conducted a preliminary hearing on the issue of Armstrong's claim to adverse possession of the bankrupt's property, and that the Referee erred in conducting a hearing on the merits of the entire matter.

In this case the court is in possession of the property and the trustee is seeking to sell the property of the bankrupt. In response to the trustee's petition to sell, Armstrong asserted its claim to adverse possession and requested an order on the trustee to surrender possession of the property to it. This "motion," presented on behalf of Armstrong, recognized possession in the court and was in effect a reclamation petition.

The cases relied upon in support of the position taken by Armstrong are cases wherein the adverse claimant was in actual physical possession of the property involved and the receiver or trustee in bankruptcy was seeking a turnover order against said property. The decisions relied upon by the petitioner Armstrong to support this contention are not in point. See *Continental Casualty Co.* v. *White,* 269 F. (2d) 213-216.

Whatever possession Armstrong may have had, by reason of procedures followed on November 21, 1962, was surrendered to the receiver in this case upon his appointment when he went into physical possession of the property. Armstrong attempted to attach to this sur-

render of possession certain conditions by agreement with the receiver. This agreement was rejected by the court when the matter was presented on December 6, 1962 at which time Armstrong could have elected to take the position that it subsequently attempted to take, but these matters were resolved by the order entered with the agreement of Armstrong, on December 7, 1962 which contained no provision for return of possession of the property to Armstrong. On the contrary, it is manifest from the changes made in the order of December 7, that the Referee clearly intended to reject any agreement which would provide for Armstrong to be restored to possession or to be considered to remain in possession. It is also implied in that order that the Referee intended that the court retain possession of the property and with it the right to adjudicate the validity of Armstrong's claim to a lien. Armstrong attempted by agreement with the receiver to determine the question of its right to possession of the property. This matter was rejected by the Referee who offered then and there to try the issue of possession, which Armstrong declined to do.

The contention that by reason of the petition presented on December 6, and the order thereafter entered on December 7, taking into consideration the facts and circumstances surrounding the entry of that order, that Armstrong is now entitled to be put in possession of the property, or to be considered to be in possession of the property, must be rejected. The Referee had summary jurisdiction in this matter and properly heard the entire matter on the merits. *Teasdale* v. *Robinson,* 290 F. (2d) 108 (8th Cir., 1961). If, thereafter, Armstrong's objection to the summary jurisdiction of the court was well taken, Armstrong could have participated fully on the merits without any waiver of its objection to jurisdiction, as its

able counsel must have realized. *Cline* v. *Kaplan,* 323 U.S. 97; *Teasdale* v. *Robinson,* supra. Prior to the time of its agreement with the receiver, Armstrong had participated in an administrative phase of the bankruptcy proceeding and had thereby consented to the summary jurisdiction of this court.

At a hearing before me on review of the Referee's order appointing a receiver, counsel for Armstrong, Harry Margolis, appeared on behalf of Armstrong and argued at length opposing the appointment of a receiver and in favor of keeping the debtor in possession. Although Mr. Margolis referred to his appearance before me as special, this label seems meaningless under the circumstances. A party cannot ask the court to do something on its behalf and thereby invoke the jurisdiction of the court, as Armstrong did, on a special appearance. The only relief that can be asked by a party on a special appearance is that he be dismissed from court.

On this occasion Harry Margolis, attorney for Armstrong, made the statement (Tr. Ex. 108) that Armstrong did not foreclose its mortgage but took possession to protect creditors. The Referee correctly held that Armstrong could not lawfully take possession of the property involved here without first giving Manz fifteen (15) days notice, as provided in the loan agreement of December 14, 1961 and the letter of the same date from Armstrong to Manz to the same effect. (Tr. Ex. 45.) In the absence of such notice, Armstrong's possession was unlawful and its claim to be in adverse possession is devoid of any legal merit. *In re Kolar,* 296 F. (2d) 717 (7th Cir. 1961).

Armstrong's claim to possession of all of the assets of Manz, personal and real, finds no support in the record. The Referee correctly ruled that by reason of the explicit

exclusion of the inventory, work in process and raw materials from Armstrong's chattel mortgage, rendered any claim to possession of that property without any color of right. The same is true as to the real estate, there being no provision in the trust deed for Armstrong to take possession in case of default. Furthermore, the Illinois Statute requires a court order for a mortgagee to be put into possession. Ill. Rev. Stat. Ch. 95, Sec. 23. Armstrong, likewise, had no basis to claim the substantial amount of third party property which is the subject matter of seventeen reclamation petitions filed in this proceeding. All of the foregoing property was clearly outside the scope of the Armstrong claim and vested the court with summary jurisdiction through the entire controversy. Once bankruptcy proceedings are filed, the jurisdiction of the bankruptcy court is paramount. *Straton* v. *New,* 283 U.S. 318 (1931); *Emil* v. *Hanley,* 130 F. (2d) 369, 2 Cir. 1942; *In re Lustron,* 184 F. (2d) 789 (7th Cir. 1950).

Armstrong relies on the case *In re Display Stage Lighting Company, Inc.,* 56 F. (2d) 1046, in support of its contention that the Referee was required to honor the agreement made by the receiver with it relative to the return of possession of property. In the *Display* case a sheriff's sale was held at which one Greenfield was the purchaser. After the sale the original owner (judgment debtor) filed a bankruptcy petition and a receiver was appointed. The bankruptcy receiver took possession from Greenfield subject to an agreement between them that Greenfield's claim to adverse possession would be recognized by the bankruptcy court. At a subsequent hearing the court did honor its receiver's agreement for recognition of Greenfield's claim to adverse possession. But this case is not applicable to the facts in the instant case. In the *Display* case

there was a completed levy and sale with title passing to the purchaser, Greenfield. In the instant case there was no sale nor was there a foreclosure proceeding, but title remained in the bankrupt and possession to the extent that it was taken by Armstrong was unlawful. It is apparent that the *Display* case, *supra,* is inapposite and does not support Armstrong's position in this case.

The order of November 27, 1963, finds that the liens asserted on behalf of Armstrong under the trust deed and chattel mortgage of December 14, 1961 are null and void as fraudulent transfers under § 67d(2), sub-sections (b), (c), (d) and 70e of the Bankruptcy Act. The transactions that took place on that date between Armstrong and Manz are hereinabove set forth in detail in the Summary of Facts.

From the record, it is clear that approximately $1,500,000, proceeds of the loan transaction of December 14, 1961, were paid to George Schwartz as escrow agent for the selling shareholders of the Manz stock, which stock was acquired by Armstrong as part of the loan transaction. The Referee's findings in relation to this transaction are fully supported in the record and the facts clearly establish that there was a lack of fair consideration for the transfers in question.

In addition to proof of a lack of fair consideration to render a transaction voidable under § 67d(2)(b), (c), there must be proof, as to (b)—of the debtor being left with unreasonably small capital for the continuance of its business; and as to (c)—a belief by the debtor that it would incur debts beyond its ability to pay as they matured.

With respect to this requirement of (b), the record clearly establishes that Manz was left with an unreasonably small amount of capital for the continuation of its business. The proof of Manz' inability to pay its debts as

they matured is in the testimony of Laden, Fund, Lattanzio, Margolies, Goble and in Trustee's Exhibit 78 (showing an increase of debt from some $550,000 in December, 1961 to over $1,100,000 in November, 1962) and is in the evidence of overdrafts on the bank (Tr. Exhibit 70). Directly in point is *In re Atlas Foundry Co.*, 155 F. Supp. 615 (D. N.J. 1957) at page 618.

That the loan transaction of December 14, 1961 violates § 67d(2) (b), is clearly and conclusively demonstrated by this record.

With respect to §67d(2) (c), the same evidence supports the Referee's conclusion that the bankrupt believed that it would incur debts beyond its ability to pay as they matured. It also is clear that Armstrong knew, or should have known, that the debtor would incur debts beyond its ability to pay. Armstrong's examiners had full access to the financial records of Manz and it is chargeable with knowledge of the contents of the Manz records. Depriving a financially hard pressed debtor of $2,000,000 of working capital could have no other result than to create a belief that the debtor would incur debts beyond its ability to pay as they matured.

It would require no guess work on the part of a trier of facts to find such a belief on the basis of this record. See 4 Collier, Bankruptcy 67.36. *Kindom Uranium Corp.* v. *Vance,* 269 F. (2d) 104 (10 Cir. 1959). In any event the existence of such an intent is a question of fact. *Hartnell* v. *Doyle,* 16 Tenn. App. 302, 64 S.W. 2d 227 (1932) (Applying UFCA), and there is no basis to disturb such finding by the Referee.

The Referee also invalidated the transfer to Armstrong under subdivision 67d(2) (d) which voids transfers made by a debtor with an actual intent to hinder, delay or defraud creditors. In dealing with the actual intent required

by this subdivision (d), intent to hinder or delay is condemned equally with an intent to defraud. 4 Collier on Bankruptcy, 67.37 (14 Ed. 1962).

The issue of actual fraudulent intent is one of fact. *Richardson* v. *Germania Bank,* 263 Fed. 320 (2nd Cir. 1919). The finding of a referee who has heard oral testimony on this issue is entitled to great weight on appeal in view of the peculiar importance in a 67d(2) (d) case of the credibility of witnesses examined on the intent issue.

In re Gallis, 115 F. (2d) 626 (7th Cir. 1940), Cert. denied 312 U.S. 704, 1941.

The finding of the requisite intent may be predicated upon the concurrence of facts which, while not direct evidence of actual intent, lead to the irresistible conclusion that the transferor's conduct was motivated by such intent. *McWilliams* v. *Edmonson,* 162 F. (2d) 454 (5th Cir) 1957. Courts have repeatedly observed that each case under § 67d (2) (d) must depend upon its own facts. 4 Collier 67.37, pp. 374-381.

In re Chorost v. *Grand Rapids Factory Show Room, Inc.,* 172 F. (2d) 327 (3rd Cir. 1949), the court held in construing subdivision (d) that the finding of the requisite intent could be predicated upon the concurrence of facts which, while not direct evidence of actual intent, would lead to the irresistible conclusion that the transferor's conduct was motivated by such intent.

In the case of *In re Venie,* 80 F. Supp. 250 (W.D. Mo. 1948), the court held that where the transferee and owner of the transferor had knowledge that the transfer would deplete the debtor's assets and deprive creditors of their right to be paid out of the firm's property in a transaction

in which the consideration would not run to the benefit of the debtor, the transaction was fraudulent, and the chattel mortgage which was part of the transaction was void. In this Circuit our Court of Appeals in *Edward Hines Western Pine Co.* v. *First National Bank,* 61 F. (2d) 503 (1932), held transfers by the owners of a bankrupt which benefited the owners personally and not the bankrupt corporation was a transfer to hinder, delay or defraud creditors. Also see *Lytle* v. *Andrews,* 34 F. (2d) 252 (8th Cir. 1929). *M. V. Moore & Co.* v. *Gillmore,* 216 F. 99 (4th Cir. 1914), for cases involving purchase of shares by corporations which were held to be fraudulent.

The foregoing authorities fully support the Referee's finding that the transfers were fraudulent under § 67d(2)(d). The consequences or result of the withdrawal of $2,000,000 in working capital from the debtor and the placing of its prior lien for $2,500,000 against all the assets of Manz could only result in hindering and delaying creditors in the obtaining of payment of their claims or result in their being unpaid and the creditors defrauded. Armstrong's intention to cause just such a result is fully supported by the record. It is elementary that a party is held to intend the natural consequences of his acts. Armstrong's arranging for and causing the unwarranted withdrawal of $2,000,000 in working capital from Manz at a time when Manz was having difficulty paying its debts clearly and conclusively justifies the Referee's conclusion that the transaction of December 14, 1961 is voidable under § 67d(2)(d) of the Bankruptcy Act. Additional support for this conclusion rests on the evasive testimony of Armstrong's witnesses covering the transaction. *Autrey Bros. Inc.* v. *Chichester,* 240 F. (2d) 498 (9th Cir. 1957); the manner in which the proceeds of the loan were paid to a

third party (Schwartz, attorney for the debtor) rather than directly to the shareholders, which would have made tracing the proceeds of the loan much easier; Armstrong's vacillating between the position of shareholder and that of a secured creditor depending upon the circumstances; the hindrance and delay to creditors, is conclusive in Trustee's Exhibit 78.

On the basis of this record, I hold that the Referee could make no finding other than the transfer of December 14, 1961 is void under § 67d(2) (b), (c), (d), of the Bankruptcy Act.

That Armstrong is not entitled to the saving provision of § 67d (6) in favor of a bona fide lienor as to that portion of the proceeds of the loan that actually benefited Manz, is manifest from the Referee's finding of actual fraudulent intent on its part in the transaction under § 67d (2) (d). Armstrong cannot possibly claim that it acted in "good faith" as a bona fide lienor without fraudulent intent. 4 Collier 67.41, pp. 421-428. Brief pp. 107-108. See *In re B-F Building Corporation*, 321 F. (2d) 691 (6th Cir. 1963), *In re Venie*, 80 F. Supp. 250 (W.D. Mo. 1948).

The Referee also found the transaction in question violated § 70e of the Bankruptcy Act which incorporates State law as grounds for invalidation. Armstrong has shown no error in the Referee's rulings that the transfers to it are voidable under the Illinois Statute relating to fraudulent conveyances. Ill. Rev. Stat. Ch. 59, 4; *Woodham* v. *Miller*, 319 Ill. App. 388; *Phillips* v. *Kesterson*, 154 Ill. 574; *Sherwin-Williams Co.* v. *Watson Indus.*, 361 Ill. 598, are cases in point supporting the Referee's ruling as to the transfers to Armstrong constituting fraudulent conveyances under Illinois law.

Nor has Armstrong shown that there is any error in the Referee's conclusion that the transfers are voidable as

part of a conspiracy to cause an illegal redemption of the shares of stock of Manz at a time which Manz was unable to pay its debts as they matured in violation of § 6 and § 58 of the Illinois Business Corporation Act. Ill. Rev. Stat., Ch. 32, §§ 157.6, 157.58. *In re Kranz Candy Co.*, 214 F. (2d) 588 (7th Cir., 1954), is directly in point. Also see *Maggiore* v. *Bradford*, 310 F. (2d) 519 (6th Cir. 1962).

In addition to invalidating the liens held by Armstrong against the Manz properties arising out of the loan agreement of December 14, 1961 as being contrary to the provisions of 67 and 70 of the Bankruptcy Act, the Referee subordinated the entire claim of Armstrong including the claims based upon advances made to Manz secured by assignments of accounts receivable, as well as the chattel mortgage loans of May 24 and June 10, 1962.

The subordination was based upon the Referee's finding that the bankrupt Manz was the alter ego of Armstrong; that Armstrong was not a secured creditor but in substance the owner of Manz through its holding of over 90% of its stock and its control over all of its income. Further grounds for the subordination, in the Referee's order, are predicated upon the unfair, inequitable, unconscionable and fraudulent conduct of Armstrong in its transaction with Manz to the detriment and damage of its creditors.

Armstrong in its briefs claims the Referee erred in his order of subordination; that it was a mere lender or mortgagee holding Manz' shares of stock as collateral security; that it made a loan of $2,500,000 to Manz and Manz distributed the proceeds; and further that it had nothing to do with the redemption and that it did not deprive Manz of any working capital; and that the transaction was at "arms length". Armstrong contends there is no evidence of domination, control, breach of fiduciary duty

or faithless stewardship as required by the cases it cites for subordination. An examination of the cases cited by Armstrong in its brief discloses that they are not applicable to the facts in this record.

The Referee found, as stated above, that the transaction of December 14, 1961 was made with intent to hinder, delay and defraud creditors; that Armstrong participated and directed the illegal redemption of stock which deprived Manz of $2,000,000 of working capital; and that the conduct and actions of Armstrong toward Manz and its creditors were unfair, inequitable and unconscionable.

Armstrong does not show that any such findings of the Referee are in any way erroneous. On the contrary, the record fully supports these findings of the Referee. That such findings fully support the order of subordination is clear from the applicable authorities. 3 Collier on Bankruptcy, 14 Ed. 57.14, 63.06, 63.08, 65.06 and cases cited. *Bell Tone Records, Inc.*, 86 F. Supp. 806 (D. N. J. 1949). *International Tel. & Tel. Co.* v. *Holton*, 247 F. (2d) 178 (4th Cir. 1947). *Pepper* v. *Litton*, 308 U. S. 295. *Central States* v. *Luther*, 215 F. (2d) 38, 46 (10th Cir. 1954). *Costello* v. *Fazio*, 256 F. (2d) 903 (9th Cir. 1958). In the latter case the court held that a finding of fraud was not essential to an order of subordination. Cases in point are collected in an article by Harry S. Gleick in the 33rd Edition of the Journal of the National Association of Referees in Bankruptcy, page 69 (1959), wherein the author set forth grounds or basis for subordination applied by the courts, most of which were present in this record.

The evidence of Armstrong's control, domination, spoliation, ownership and breach of fiduciary duty is clearly established by the record and fully justifies the Referee's order of subordination of Armstrong's entire claim.

General Order 47 of the General Orders in Bankruptcy is in part as follows:

> "Unless otherwise directed in the order of reference the report of the referee or special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact *unless clearly erroneous.*" (Emphasis added.)

Rule 52a of the Federal Rules of Civil Procedure is to the same effect.

Considering the numerous assignments of alleged error by Armstrong in its 137 page petition for review, in the light of my duty to accept the Referee's findings unless clearly erroneous, it is clear to me that most of the assignments are without merit and that it would unduly further prolong this already too lengthy opinion to answer each and every assignment. However, grouping the assignments into five principal categories, the first and principal group of objections of Armstrong is that the evidence offered was immaterial upon the only issue in the proceeding, namely, that of summary jurisdiction. This objection is a re-argument of the issue of summary jurisdiction which has been clearly answered above. The Referee correctly ruled that the bankruptcy court has summary jurisdiction so that the evidence offered was material and competent to the issues presented by the pleadings.

A second group of objections is that on the competent material evidence the Referee should have made different and contrary findings of fact. For example, Armstrong asserts, at page 46 of its Brief, that the Referee should have found Harry Margolis was not the attorney for Armstrong, implying that Armstrong was not bound by his statements to the court in his objections to the appointment of a receiver and his statement as to Armstrong's

possession being for the protection of the creditors. Armstrong's witness Rubin so testified. However, on the record disclosing Margolis' responding to an invitation to speak in open court in behalf of Armstrong in the presence of, and without objection from the witness Rubin, and considering Margolis' participation in negotiations with creditors as a representative of Armstrong (with Rubin, Armstrong's attorney), the Referee was clearly correct in his finding.

The Referee's finding of Manz' inability to pay its debts as they matured in the regular course of business is another example of finding assigned as erroneous by Armstrong. The finding is conclusively established by the testimony of Lattanzio, Laden, Margolies, Fund, Goble and Trustee's Exhibit 78. Other conflicts in the testimony were correctly resolved by the Referee in accordance with his function as trier of the facts. *In re Gordon* v. *Gelberg,* 69 F. (2d) 81, 83 (2nd Cir. 1934). *In re New Style Hat Mfg. Co.,* 43 F. Supp. 122 (N. D. Ohio, 1940). Indeed, Armstrong in its objections relies upon testimony of its witnesses which was rejected by the Referee and which cannot be considered as a basis for setting aside a finding as clearly erroneous. *United States f.u.o. Browne & Bryan Lumber Co.* v. *Massachusetts Bond & Ins. Co.,* 303 F. (2d) 823, 827 (2d Cir.) 1962.

Another or third group of assignments of error is that the Referee failed to make findings which he should have made. In none of these alleged errors does Armstrong cite record references or exhibit references which would support such proposed findings so that I am without information as to the basis for such suggested findings. See *Dearborn National Cas. Co.* v. *Consumers Petroleum Co.,* 164 F. (2d) 332, 333 (7th Cir. 1947). It appears to me

that either there is no evidence to support the numerous suggested findings or in other instances that the findings would have to rest upon rejected testimony.

A fourth group of objections is that the Referee should have drawn different inferences from evidence which Armstrong does not contradict. Inferences to be drawn from the evidence is clearly a function of the Referee. *In re Gordon* v. *Gelberg,* 69 F. (2nd) 81, 83. An example is the objection, at page 46 of Armstrong's Brief, that the Referee erred in failing to find that when Margolis testified Armstrong took possession to protect creditors that any equity remaining would be available for creditors. The Referee correctly inferred from this statement, in the absence of any claim to adverse possession, that Margolis meant what he said, namely, that Armstrong took possession to protect creditors and not as an adverse claimant or to foreclose its mortgage.

A fifth and final group of objections consist of miscellaneous alleged assignments of error which are without any basis whatsoever. For example, repeatedly Armstrong complains that the Trustee failed to offer in evidence certain exhibits. The record discloses Armstrong produced these documents in response to a subpoena of the Trustee, that they were marked for identification but were not offered in evidence. Armstrong did not offer these or require ruling from the Referee requiring the Trustee to offer them. Accordingly, there is no basis for complaint nor does Armstrong cite authority in support of its position.

Considering the entire Petition for Review and each of the numerous assignments of error contained therein in the light of General Order 47, it is my considered judgment

that Armstrong has failed to show where the Referee has committed any error. The record instead fully and clearly supports the findings of fact, the conclusions of law, and the orders entered by the Referee and sought to be reversed by Armstrong's Petition for Review. Accordingly, I hereby adopt and affirm said findings of fact, conclusions of law and orders and deny the prayer of the said Petition for Review. The orders of November 27, 1963 and December 2, 1963 are hereby affirmed.

Enter:

Campbell,
Chief Judge.

Date December 4, 1964.

SUPREME COURT, U. S.

No. 909

Office-Supreme Court, U.S.
FILED
FEB 23 1967
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966.

EDWARD LIMPERIS, TRUSTEE IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.,

Petitioner,

vs.

A. J. ARMSTRONG CO., INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

NORMAN H. NACHMAN,
38 S. Dearborn Street,
Chicago, Illinois 60603,
JOSEPH STEIN,
1 N. LaSalle Street,
Chicago, Illinois 60602,
ALLAN G. SWEIG,
38 S. Dearborn Street,
Chicago, Illinois 60603,
Attorneys for Respondent.

THE BUNTHORP-WARREN PRINTING COMPANY, CHICAGO

INDEX.

	PAGE
Citation to opinion below	1
The statutes involved	1
Question presented	2
Statement of the case	2
Argument in opposition to the petition	11
I. There is no support for the petition	11
II. Petitioner concedes respondent's adverse possession and the substantiality of its secured claims	12
III. Petitioner's pending plenary action provides the only means for determining in one trial all the rights and claims of all the parties	12
IV. The Court of Appeals in reversing followed the decisions of this Court	14
V. The decision of the Court of Appeals will prevent further delay and waste	16
VI. There is no conflict among the circuits	18
VII. Orders overruling objections to summary jurisdiction are appealable	24
VIII. The guaranteed right to challenge summary jurisdiction may not be nullified	25
Summary	27
Conclusion	28
Appendix A—Petitioner's amended complaint in pending plenary action in the United States District Court for the Northern District of Illinois filed December 13, 1966	App. 29

Table of Authorities.

Cases.

Allison v. Morris Plan Co. of Tampa, 69 F. 2d 17 (C. A. 5, 1934) 20

American Mannex Corp. v. Huffstutler, 329 F. 2d 449 (C. A. 5, 1964) 21

Beacon Theatres v. Westover, 359 U. S. 500, 503-4, 510-11 (1959) 27

Board of Education of Salt Lake City, Utah v. Leary, 236 Fed. 521 (C. A. 8, 1916) 25

Board of Road Comr's. v. Keil, 259 Fed. 76, 81-82 (C. A. 6, 1919) 20

In re Brokol Manufacturing Company, 221 F. 2d 640, 642-3 (C. A. 3, 1955) 26

Buss v. Long Island Storage Warehouse Co., 64 F. 2d 338 (C. A. 2, 1933) 22

In re Christ's Church of the Golden Rule, 172 F. 2d 523 (C. A. 9, 1949) 24

City and County of Denver v. Warner, 169 F. 2d 508, 512 (C. A. 10, 1948) 26

Cline v. Kaplan, 323 U. S. 97 (1944) 5, 11, 14

Continental Cas. Co. v. White, 269 F. 2d 213 (C. A. 4, 1959) 18

Dairy Queen, Inc. v. Wood, 369 U. S. 469 (1962) 27

In re Display Stage Lighting Co., 56 F. 2d 1046 (S. D. N. Y. 1932) 20

In re Federal Photo Engraving Corp., 54 F. 2d 628 (C. A. 2, 1931) 24

Fish v. East, 114 F. 2d 177 (C. A. 10, 1940) 22, 23

In re Greenstreet, Inc., 209 F. 2d 660, 662 (C. A. 7, 1954) 25
Giffin v. Vought, 175 F. 2d 186 (C. A. 2, 1949)..... 18
Gill v. Phillips, 337 F. 2d 258 (C. A. 5, 1964)..... 25
Harrison v. Chamberlin, 271 U. S. 191 (1926).....
.....5, 11, 14, 15, 23, 24, 25, 26
In re Hollingsworth & Whitney Co., 242 Fed. 753 (C. A. 1, 1917) 20
Johnson v. Wilson, 118 F. 2d 557 (C. A. 9, 1941)..... 18
In re Kansas City Journal-Post Co., 144 F. 2d 812 (C. A. 8, 1944) affirming 51 F. Supp. 1009 (W. D. Mo. 1943) 23
Katchen v. Landy, 382 U. S. 323 (1966).....14, 15
Kelso v. Maclaren, 122 F. 2d 867, 869 (C. A. 8, 1941).. 24
Lieberman v. Bancroft, 69 F. 2d 202 (C. A. 3, 1934)... 24
Louisville Trust Co. v. Comingor, 184 U. S. 18 (1902) 26
MacDonald v. Plymouth County Trust Co., 286 U. S. 263, 266 (1932) 15
Mueller v. Nugent, 184 U. S. 1 (1901).....5, 11, 14
O'Dell v. United States, 326 F. 2d 451 (C. A. 10, 1964) 18
In re Rosenberg, 128 F. 2d 924 (C. A. 7, 1942)..... 26
Rothbart v. Metropolitan Trust Co., 307 Ill. App. 271, 276, 30 N. E. 2d 183 (1940)..... 22
Roy v. Goings, 96 Ill. 361 (1880)..... 22
Suhl v. Bumb, 348 F. 2d 869 (C. A. 9, 1965), cert. denied 382 U. S. 938 (1965)..... 15
Sulmeyer v. Pfohlman, 329 F. 2d 915 (C. A. 9, 1964).. 24
Taubel-Scott-Kitzmiller Co. v. Fox, 264 U. S. 426 (1924) 11, 14, 15
Teasdale v. Robinson, 290 F. 2d 108 (C. A. 8, 1961)..22, 23

Thompson v. Magnolia Petroleum Co., 309 U. S. 478, 483 (1940) 17

Trieber v. England, 237 F. 2d 117 (C. A. 9, 1956), cert. denied, 352 U. S. 967 (1957) 24

Tuttle v. Harris, 297 U. S. 225 (1936) 21

Ullman, Stern & Krausse v. Coppard, 246 Fed. 124 (C. A. 5, 1917) 18

United States v. Southern Constructors, Inc., 211 F. Supp. 537 (W. D. Mo. 1962) 20

Universal Oil Products Co. v. Cosden Petroleum Corp., 178 F. 2d 495 (C. A. 5, 1949) 24

Statutes.

Bankruptcy Act:

§ 2a(7); 11 U. S. C. A. § 11a(7) 1, 16

§ 23b; 11 U. S. C. A. § 46(b) 1, 2, 15, 16

§ 39c; 11 U. S. C. A. § 67(c) 24

28 U. S. C. A. § 1292(b) 25

Miscellaneous.

2 Collier on Bankruptcy, § 39.21, pp. 1499-1501 24

MacLachan's Handbook on the Law of Bankruptcy, sec. 194, n. 24, p. 208 (1956) 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966.

No. 909.

EDWARD LIMPERIS, TRUSTEE IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.,

Petitioner,

vs.

A. J. ARMSTRONG CO., INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CITATION TO OPINION BELOW.

The opinion of the court below is reported in 369 F. 2d 513.

The judgment of the Court of Appeals was entered on July 29, 1966. Rehearing *en banc* was denied on October 3, 1966 by a vote of 7 to 1.

THE STATUTES INVOLVED.

Petitioner incorrectly implies that the only statutory provision involved is § 2a(7) of the Bankruptcy Act, 11 U. S. C. A. § 11a(7). The fact is, however, that § 23b of the Bankruptcy Act, 11 U. S. C. A. § 46(b), is more directly involved and provides:

"(b) Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this title had not been instituted, unless by consent of the defendant, ..."

QUESTION PRESENTED.

Although petitioner states that several questions are presented for consideration by this Court, actually there is only one question before this Court, namely: when summary jurisdiction is timely challenged by an adverse claimant in possession, whose claim is clearly substantial, may the bankruptcy court refuse under the well established law to conduct a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable, and instead, over the persistent objections of the adverse claimant, insist on conducting an immediate trial on the merits which involve complicated issues of law and fact?

STATEMENT OF THE CASE.

Since petitioner's statement of the case is inaccurate and incomplete, respondent sets forth its statement of the facts material to the consideration of the question presented.

Respondent's Secured Claims.

Commencing with December 14, 1961, A. J. Armstrong Co., Inc. (respondent), made loans to the bankrupt in excess of $2,700,000 on the security of the bankrupt's real estate and equipment (R. 382-393, 398, 1085, 1143, 1152, 1169—par. 2, 1215, R. Vol. V 45-48, 49-52, 53-57, 61, 62-66, 67, 68-73). Respondent also made accounts receivable loans aggregating $5,600,000 (R. 396) on which at the date of bankruptcy there was a balance due in excess of $1,085,888 (R. 398). On November 21, 1962, when respondent took

actual adverse possession, the bankrupt owed respondent $3,764,724 (R. 398). The bankrupt in its schedules filed in the bankruptcy proceeding admitted respondent was a secured creditor in the aggregate sum of $3,742,965 and that its claims were neither contingent nor disputed (R. 39-40).

Petitioner has never disputed the amount of the loans made by respondent.

Respondent's Adverse Possession Taken After Defaults.

On November 21, 1962, two days prior to the filing of the involuntary bankruptcy petition, the bankrupt had been in default for several months (R. 400, 405) in its obligations to respondent. On that date respondent, to protect its collateral (R. 405), and in accordance with law, took peaceful, exclusive, adverse, physical possession of the building and equipment which was the security for its loans (R. 439, 472-483, 542-47, 557-58, 618-22). Some of the bankrupt's defaults which necessitated respondent's protective action were the following:

(a) the bankrupt's failure for five consecutive months to make its monthly payments then aggregating $230,000 (R. 400, 1083);

(b) the existence of unpaid judgments for substantial sums (R. 404, 1335, 1339);

(c) the pendency of a replevin action (R. 1307);

(d) threats of levies by judgment creditors (R. 404-05, 1303-08);

(e) the pendency of law suits by creditors having substantial unpaid claims (R. 404-05, 1303-08, 1340);

(f) threat of cancellation of insurance covering the bankrupt's property (respondent's security) because of non-payment of premiums (R. 1307); and,

(g) threat of a strike because of bankrupt's non-payment of sums due to the union health and welfare fund (R. 1308).

On November 23, 1961, the involuntary petition in bankruptcy was filed (R. 1). Respondent's actual possession of its collateral was admitted in three different documents filed by the petitioning creditors and other creditors (R. 14, 1299, 1301-02).

On November 26, 1962, five days after respondent took possession, the receiver was appointed but did not attempt to remove respondent or take possession of the building or equipment (R. 8, 457-58, 519, 528).

Respondent's Agreement With the Receiver.

On the evening of November 27, 1962, respondent pursuant to a detailed agreement (R. 22-24) with the receiver and creditors holding approximately fifty per cent of the general unsecured claims, permitted the receiver conditional entry and use of the building and equipment. The terms and conditions of that agreement are admitted by the receiver and set out in his petition filed December 6, 1962 (R. 20-27). The agreement, *inter alia,* expressly provides that if an order of adjudication in bankruptcy is entered, the receiver shall restore respondent to its possession, and respondent's rights as adverse claimant shall be determined as of the date of bankruptcy which was two days after respondent had taken adverse possession (R. 22-23).

The Referee's Order of December 7, 1962.

On December 7, 1962, the referee entered an order (R. 35) on the receiver's petition (R. 20-27). The order, *inter alia,* provided (R. 36):

> "IT IS FURTHER ORDERED that . . . the rights and questions of jurisdiction as to, and possession of A. J. Armstrong Co., Inc. shall be considered and determined in all respects as of the time of filing of the above [bankruptcy] proceedings. . . ."

Receiver's Refusal to Honor His Agreement.

On January 31, 1963, an order of adjudication in bankruptcy was entered and respondent demanded return of possession in accordance with its agreement with the receiver (R. 1297-98). The receiver refused to honor his agreement. On February 4, 1963, the receiver filed a petition to sell respondent's collateral, and an order was thereupon entered directing respondent to assert within ten days its right, title and interest in said property or be forever barred and enjoined from claiming any interest therein (R. 50-57, 58-59).

Respondent's Motion Challenging Summary Jurisdiction and Referee's Refusal to Conduct Preliminary Inquiry.

On February 14, 1963, in response to the referee's order of February 4, 1963, respondent filed its motion challenging summary jurisdiction. This motion, *inter alia,* incorporated the promissory notes and mortgages held by respondent; set forth respondent's adverse possession for two days prior to and at the date of bankruptcy; referred to its November 27, 1962 agreement with the receiver, and prayed that since the receiver refused to honor his agreement that respondent be deemed to have been in continuous adverse possession (R. 60-73).

On April 1, 1963, at the commencement of the hearings on respondent's motion challenging summary jurisdiction, respondent cited the controlling decisions of this Court, namely, *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926); *Cline* v. *Kaplan,* 323 U. S. 97 (1944) and *Mueller* v. *Nugent,* 184 U. S. 1 (1901), and respectfully urged that the referee conduct a preliminary inquiry to determine whether respondent's adverse claim was real and substantial or merely colorable (R. 369-376). This the referee refused to do.

Instead, on that date and at all times thereafter, despite the persistent objections of respondent, the referee continued to refuse to conduct a preliminary inquiry and insisted that he was going to hear "all of the evidence" in the entire case (R. 372, 470, 984-85, 989, 1043). On August 6, 1963, the referee stated (R. 989-990):

> "The Referee: I think that certainly I have made it clear, and I don't want anyone to be misled, or in the dark on it by my rulings and by things that I have said. I have indicated very clearly that I wanted to hear all of the evidence in this case.
>
> "I don't recognize now, *nor have I at any time,* that the only factual issue was one of possession. I am aware of the question that has been raised with respect to jurisdiction, but I nevertheless am ruling, and have said that I want to, and intend to hear all of the evidence. Now, this means just exactly what I have said,—*all of the evidence.*
>
> "Most certainly, without in any way jeopardizing any positions that anybody has taken, I still persist and I insist, if you have got evidence to offer, offer it and put it in, and this applies to both Armstrong and the Trustee. And, when *all of the evidence is in and the matter is closed, then I will consider the whole, the entire matter. I don't intend to make any rulings of any phase of the matter until all the evidence is in, and I think that I made this very clear right from the outset. If I didn't I am doing so now.*
>
> "I don't expect that you necessarily agree with this procedure or this approach, but I am convinced in my own mind that this is part of the responsibility that I have in this case, and I therefore am going to hear all of the evidence.
>
> "Mr. Nachman: We have, from the very commencement of this proceeding, respectfully disagreed with the Court in this respect, and we should like the record to show we continue, respectfully, to disagree with the Court.
>
> "It is Armstrong's feeling that this hearing has been continued way beyond the scope authorized by the

cases on the subject, and this should have been a preliminary inquiry to ascertain whether or not Armstrong's claim of adverse possession is purely (or simply colorable, or whether it has substance in fact.

"All I can say, your Honor, is with the greatest respect for the Court, we just disagree.

"The Referee: I think you have made your position clear. I think the record reflects this and *I still say that I am going to conclude the matter on the premise that I originally adopted, and that is it.* You may guide yourselves accordingly.

"I say, I may be right or wrong, but I feel this is the proper way to do it and I intend to do it this way.

"There you have it, gentlemen. There can't be any misunderstanding with respect to this, I trust." (Emphasis ours.)

On October 17, 1963, respondent objected to petitioner's introduction in evidence of certain depositions because they were immaterial and irrelevant to the jurisdictional objection before the court. The referee again reaffirmed his determination to hear "all of the evidence" before ruling on respondent's objection to jurisdiction (R. 1043):

"The Referee: Are the objections you made in the depositions the same as you have been making here?

"Mr. Nachman: Yes, Your Honor.

"The Referee: I don't think it is necessary then, at least for my convenience, to refer specifically to page numbers. I haven't read the depositions, but if the statement of objections is as you say, then I will say *it was my original announced intention that I would hear all of the evidence.*

"These objections are overruled and the documents will be admitted." (Emphasis ours.)

Throughout the extended hearings from April 1, 1963 to October 24, 1963, respondent repeatedly asserted its objections to summary jurisdiction and urged that a preliminary

inquiry be conducted.* Respondent's objections were overruled.

Respondent Limited Its Evidence to Summary Jurisdiction.

Respondent limited its participation in the hearings to its introduction of evidence and cross-examination of witnesses on its jurisdictional objection and to establish that its adverse claims were real and substantial.

The Orders of the District Court and the Referee.

It was not until November 27, 1963, eight months after the start of the hearings on respondent's motion challenging jurisdiction, that the referee overruled respondent's objections to summary jurisdiction and in the same order made voluminous findings of fact on the merits of respondent's claims and ordered that its secured claims for $3,764,724 be subordinated to the claims of all unsecured creditors (R. 153-199). On December 2, 1963, the referee entered an order authorizing the petitioner to sell respondent's collateral (R. 199-202). The sale was stayed upon approval of respondent's supersedeas bonds (R. 330).

On December 20, 1963, respondent filed its petition to review the referee's orders of November 27, 1963 and December 2, 1963 (R. 208-299).

On December 4, 1964, the district court denied the petition for review and affirmed the referee's orders (R. 331-363).

---

* Record pages: 109, 147, 151, 369-373, 418, 419, 420, 426, 429-433, 467, 468-471, 582, 586, 587, 589, 592, 597, 598, 604, 605, 607-08, 609, 666, 667, 673, 729, 730, 776, 777, 799, 823, 840, 856, 862, 882, 883, 901, 931, 942, 950, 955, 976, 980, 988, 989, 1000, 1013, 1015, 1016, 1019, 1029, 1030, 1032, 1033, 1034, 1035, 1036, 1037, 1041, 1042, 1043, 1045, 1046, 1060, 1404, 1573, 1629, 1632, 1665, 1668.

Petitioner's Pending Plenary Action.

On January 29, 1965, petitioner filed a plenary action against respondent seeking the identical relief sought by him in the summary proceedings (R. 1063-73). This action is still pending in the United States District Court for the Northern District of Illinois, Eastern Division. On February 18, 1966 respondent filed its answer denying petitioner's claims and also filed counterclaims against the bankrupt, the petitioner and third parties seeking, among other things, foreclosure of its mortgages (R. Vol. V, 21-34) and payment by petitioner of moneys which he failed to remit pursuant to court order (R. Vol. V, 35-38). On February 28, 1966 respondent also filed a third party complaint against former officers, directors and shareholders of the bankrupt for fraudulently inducing respondent to make its loans to the bankrupt (R. Vol. V, 94-116).

On December 13, 1966, ten months after respondent filed its third-party complaint, petitioner amended his complaint in the plenary action to include a claim against certain of the former officers, directors and shareholders of the bankrupt for misappropriation of $1,438,555 of the proceeds of respondent's loans to the bankrupt; a copy of petitioner's amended complaint is printed in Appendix A hereto, *infra* p. 29.

Respondent has demanded trial by jury in the plenary action (R. Vol. V, 2, 105).

The Decision of the Court of Appeals.

The Court of Appeals reversed the order of the district court and held that the bankruptcy court did not have summary jurisdiction over respondent and directed the parties "to proceed expeditiously" with the pending plenary action.

The Evidence Supporting Respondent's Secured Claims on the Merits Will Be Presented in the Pending Plenary Action.

Respondent denies petitioner's statement of alleged facts relating to the merits of respondent's claims. As is clear from the opinion of the Court of Appeals, respondent has not yet had its day in court on the merits of its claims. Therefore, the record does not contain the evidence concerning the merits of respondent's claims. This evidence will be fully presented in the pending plenary action.

ARGUMENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

I.

There Is No Support for the Petition.

This was an important case below only because the referee and the district court refused to follow the well established law repeatedly announced by this Court. In *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926); *Mueller* v. *Nugent,* 184 U. S. 1 (1901); *Cline* v. *Kaplan,* 323 U. S. 97 (1944); and *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U. S. 426 (1924), this Court held: when an adverse claimant in possession challenges the summary jurisdiction of the bankruptcy court, the referee before engaging in an extended trial on the merits must first conduct a preliminary inquiry to determine whether or not the adverse claim is real and substantial or merely colorable, and once it is established that the claim is neither colorable nor frivolous, the referee must decline to determine the merits and dismiss the summary proceedings. The Court of Appeals (rehearing *en banc* denied 7 to 1) in reversing the district court held that the law established by this Court must be followed.

Petitioner fails to demonstrate any conflict between circuits because none exists. The question presented below was neither new nor novel. The law applicable to the question was established long ago and repeatedly reaffirmed by this Court, and it has been consistently followed in all the circuits.

II.

Petitioner Concedes Respondent's Adverse Possession and the Substantiality of Its Secured Claims.

It is impossible to detect from the petition that the real issues in this case are and always have been respondent's actual adverse possession of its collateral taken two days prior to bankruptcy and the substantiality of its secured claims which, under the established law, required the referee to conduct a preliminary inquiry and rule promptly on the jurisdictional objection. Petitioner does not now nor has he ever denied that respondent took actual adverse possession of its collateral two days prior to bankruptcy, or that it has secured claims for $3,764,724. The petitioner is significantly silent on these vital issues. It was on these undisputed facts, namely, respondent's adverse possession and the substantiality of its claims, that the Court of Appeals reversed the district court.

Since petitioner concedes the real issues in the case, clearly there is no basis or support for his petition for a writ of certiorari.

III.

Petitioner's Pending Plenary Action Provides the Only Means for Determining in One Trial All the Rights and Claims of All the Parties.

In reversing, the Court of Appeals directed that the parties proceed expeditiously in the pending plenary action. In that action petitioner challenges respondent's claims on their merits, and respondent has filed its answer and counterclaim and a third party complaint against former officers, directors and shareholders of the bankrupt for possible fraud and deceit.

Significantly, at respondent's persistent urging, petitioner on December 13, 1966 belatedly joined as additional

parties defendant in the plenary action some of the former officers, shareholders and directors of the bankrupt, charging them with unlawfully appropriating for their personal benefit $1,438,555, being part of the proceeds of respondent's loans to the bankrupt (Appendix A hereto, *infra* p. 40-42). Petitioner will not deny that one of those newly named defendants, Lester Neumann, is a long-time client of the law firm of Collen & Kessler and a long-time business partner of Mr. Louis I. Kessler, a member of that firm (R. 672). Mr. Collen of Collen & Kessler is the attorney for petitioner. Unfortunately for the creditors of the bankrupt estate, it was too late on December 13, 1966 for petitioner to join other former officers, directors and shareholders of the bankrupt as defendants, namely, Mr. Louis I. Kessler and his wife, because petitioner had permitted the statute of limitations to run against them. However, respondent by timely filing its third party complaint, was able to make all the former officers, directors and shareholders, including the Kesslers, parties defendant in the plenary action.

The pending plenary action avoids multiplicity of suits and useless, expensive duplication of voluminous evidence and provides the only means for an expeditious determination of all the issues. That action also provides the only means for determining whether or not the former shareholders, directors and officers of the bankrupt misappropriated $1,438,555 as belatedly charged by petitioner, or whether those persons are guilty of fraud and deceit as charged by respondent.

IV.

The Court of Appeals in Reversing Followed the Decisions of This Court.

Petitioner asserts (Petn. 14, 15) that the opinion of the Court of Appeals is "erroneous" and "perplexing". The fact is, however, that the Court of Appeals reversed because the referee and district court refused to follow the law established by this Court. Obviously, the decision of the Court of Appeals is neither erroneous nor perplexing; it is the action of the referee and the district court that may be appropriately so characterized.

On the clear authority of *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926) and *Cline* v. *Kaplan,* 323 U. S. 97 (1944), the Court of Appeals held that the referee erred in insisting from the outset and over respondent's objections, on conducting a full trial instead of conducting a preliminary inquiry. The referee's statements quoted at pages 6 and 7 of this brief clearly establish that he at all times refused to conduct the required preliminary inquiry. The Court of Appeals properly concluded that the referee, early in the proceedings, should have sustained the objections to summary jurisdiction because respondent had then established that its claims were real and substantial.

Petitioner does not attempt to distinguish *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926), *Cline* v. *Kaplan,* 323 U. S. 97 (1944), *Mueller* v. *Nugent,* 184 U. S. 1 (1901), and *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U. S. 426 (1924). Rather, petitioner argues *Harrison* v. *Chamberlin,* one of the cases cited by the Court of Appeals, is "obsolete". This argument is without merit. It should be noted that the Court of Appeals also cited *Cline* v. *Kaplan,* 323 U. S. 97 (1944), wherein this Court reaffirmed the rule announced in *Harrison.* And as recently as 1966, in *Katchen* v. *Landy,* 382 U. S. 323, this Court cited *Cline* and *Taubel-*

Scott-Kitzmiller with approval and in footnote 9 of its opinion said that its decision in *Katchen* was governed by traditional bankruptcy law. Obviously there is nothing in *Katchen* which even remotely supports petitioner's contention that the well established rule of bankruptcy law on summary jurisdiction has been rendered obsolete.

It is also important to note that when this Court was considering *Katchen*, it denied the petition for certiorari in *Suhl* v. *Bumb*, 348 F. 2d 869 (C. A. 9, 1965), cert. denied, 382 U. S. 938 (1965). The similarity between *Suhl* and our case is striking, indeed. In *Suhl*, the referee, over the objection of the adverse claimant, conducted lengthy hearings on the merits and concluded among other things that the adverse claimant was guilty of fraud, was the alter ego of the debtor corporation, and that its claims were frivolous, colorable and not bona fide. There, too, the district court affirmed. The Court of Appeals reversed and held that despite the voluminous findings and conclusions of the referee, the bankruptcy court lacked summary jurisdiction, and it was necessary for the trustee to proceed by plenary action. Clearly, the most recent decisions of this Court establish that the rule of *Harrison* is not obsolete.

Petitioner argues (Petn. 10-12) that the long established distinction between summary and plenary jurisdiction in bankruptcy cases should be judicially abolished. This distinction was not created by judicial decree, but was enacted by Congress in the Bankruptcy Act of 1898. Sec. 23b of the Bankruptcy Act provides that the bankruptcy court, absent consent, does not have summary jurisdiction over an adverse claimant in possession. *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U. S. 426, 431 (1924); *Katchen* v. *Landy*, 382 U. S. 323 (1966), and *MacDonald* v. *Plymouth County Trust Co.*, 286 U. S. 263, 266 (1932).

It is respectfully submitted that any suggestion for repeal of § 23b must be addressed to Congress. Significantly, in

1952, when Congress amended § 2a(7) of the Bankruptcy Act, thereby requiring challenges to summary jurisdiction to be asserted within the time permitted for pleading, it did not see fit to modify or repeal § 23b.

V.

The Decision of the Court of Appeals Will Prevent Further Delay and Waste.

There is no support for petitioner's argument (Petn. 12-13) that the decision of the Court of Appeals fosters delay and waste in bankruptcy administration. The Court of Appeals specifically held that it was not the respondent but rather the referee who was responsible for the delay because he failed to dismiss the summary proceeding at the proper stage. Petitioner cannot shift the responsibility from the referee to the Court of Appeals.

The Report of Judge Sanborn, cited by petitioner (Petn. 13), is in fact support for the decision of the Court of Appeals and would place the responsibility for waste and delay on petitioner. In the Committee Report to The National Judicial Conference, August 21, 1944, quoted in *MacLachlan's Handbook On The Law of Bankruptcy*, § 194, n. 24 p. 208 (1956), Judge Sanborn and his committee stated:

> "Particularly when the case goes to the Court of Appeals upon a challenge to the propriety of a ruling as to whether summary proceedings lie, much time and money have been wasted by failure to initiate plenary proceedings in the first place."

As the Court of Appeals found, respondent's efforts to avoid delay and waste are clearly established by the record.

It is evident that the claims and rights of the various parties involved in this litigation cannot be determined in a summary proceeding. As was noted above, respondent in the plenary action has joined the former officers, share-

holders and directors of the bankrupt, charging that they may be guilty of fraud and deceit in connection with respondent's loans to the bankrupt. Petitioner, as trustee in bankruptcy, after repeated insistence by respondent, belatedly also joined some of these people as parties defendant in that action. The rights of, and claims against, most of the parties to the plenary action cannot be adjudicated in the summary proceeding because they are not parties to the summary proceeding. The fallacy of petitioner's argument is, therefore, apparent. Despite the summary proceeding, on the undisputed record in this case, petitioner, if he genuinely intends to enforce the bankrupt estate's claims against the former officers, shareholders and directors for misappropriating $1,438,555, must and should be eager to proceed in his plenary action.

The importance of the ruling of the Court of Appeals lies in the hope that it will serve to avoid in future cases the waste and delay which unnecessarily occurred here and which petitioner strangely still seeks to extend.

Petitioner erroneously argues (Petn. 15) that the decision of the Court of Appeals will result in suspension of the administration of the bankrupt estate until respondent's claims are adjudicated in the pending plenary action. There is no basis for this argument. The fact is that there has been no cessation in the administration of the estate since the ruling of the Court of Appeals. In rejecting the illegal procedure of the referee, the Court of Appeals directed that except as to the adverse rights and claims of respondent, the bankruptcy court should exercise its summary jurisdiction in the administration of the estate. In support of its ruling in this regard the Court of Appeals cited *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483 (1940).

VI.

There Is No Conflict Among the Circuits.

It should be noted that petitioner does not contend that a conflict in fact exists between the decision of the Court of Appeals and most of the cases cited by him. As to those cases, the most that petitioner appears able to say is that they conflict "in principle" with the decision in this case. Some of such cases are: *Giffin* v. *Vought*, 175 F. 2d 186 (C. A. 2, 1949); *Ullman, Stern & Kraussee* v. *Coppard*, 246 Fed. 124 (C. A. 5, 1917); *Johnson* v. *Wilson*, 118 F. 2d 557 (C. A. 9, 1941); *O'Dell* v. *United States*, 326 F. 2d 451 (C. A. 10, 1964), and *Continental Cas. Co.* v. *White*, 269 F. 2d 213 (C. A. 4, 1959). These cases are inapplicable because there the claimants unquestionably submitted voluntarily to summary jurisdiction. Moreover, it must be noted that respondent has never had its day in court on the merits of its adverse claims for $3,764,724. The improper findings of fact and conclusions of law on the merits made by the referee, clearly were not necessary for determination of respondent's objections to summary jurisdiction. The Court of Appeals concluded that since respondent established its adverse possession and the substantiality of its claims early in the proceedings, the referee should then have sustained respondent's objections to summary jurisdiction and concluded the hearing. Therefore, there was no legal basis for the extended unilateral hearing conducted thereafter solely on petitioner's evidence on the merits. The erroneous findings of fact and conclusions of law resulting from the illegal unilateral hearing on the merits, therefore, cannot be *res judicata* in the plenary action as contended by petitioner.

Petitioner completely distorts and disregards the undisputed record when he asserts (Petn. 8-9) that respondent voluntarily submitted to summary jurisdiction. It would

be difficult to find a case in which an adverse claimant objected to summary jurisdiction as persistently as respondent did in this case. There is nothing in the record which even remotely indicates that respondent sought to reverse the referee's appointment of the receiver or that it entered into any agreement with the Court, or that it filed a motion for the return of property allegedly in the Court's possession. The Court of Appeals specifically concluded that respondent did not submit voluntarily or otherwise to summary jurisdiction.

The petition to reverse the referee's appointment of the receiver was not filed by respondent, it was filed by the largest creditors (R. 13-19). The record clearly establishes that respondent was not a party to that proceeding. Significantly, petitioner (Petn. 9) fails to inform this Court that the comments which he attributes to respondent were not made voluntarily by respondent's attorney who was merely a spectator in the courtroom but were invited by the court and were made with full knowledge by the court that respondent was objecting to summary jurisdiction (R. 1766-67). The Court of Appeals so found when it held as follows:

> "[We] have read the transcript of the proceeding before the district court on review of the appointment of receiver and are unable to agree with the district court that in its appearance and participation there Armstrong [respondent] backed off from its resistance of summary jurisdiction, or consented to the referee's decision upon the merits."

Respondent's agreement with the receiver (R. 22-23) specifically provided that respondent granted the receiver conditional use and occupancy of the building and equipment with the clear understanding that the rights of respondent as adverse claimant were to be determined as of the date of bankruptcy. Significantly, petitioner fails to

inform this Court that the order of December 7, 1962 expressly provided, as the Court of Appeals found, that respondent's rights as adverse claimant in possession must be determined as of the time of filing the bankruptcy proceeding (R. 36). Obviously, respondent did not invoke the jurisdiction of the bankruptcy court by its agreement with the receiver or through the entry of the order of December 7, 1962. There is no basis for petitioner's argument that because of respondent's agreement with the receiver and the referee's order of December 7, 1962, respondent submitted to summary jurisdiction. The Court of Appeals held precisely to the contrary.

The Court of Appeals specifically held that the district court and the referee erred in characterizing respondent's motion challenging summary jurisdiction as a reclamation petition, and concluded that respondent in filing that motion for restoration of its possession did not submit to summary jurisdiction. It is ironic, indeed, that petitioner urges (Petn. 9) that respondent in insisting that the court appointed officer must honor his agreement, thereby voluntarily submitted to summary jurisdiction. The cases hold that a receiver or trustee may not repudiate such agreements and at the same time assert rights which were made available solely thereunder. *Allison* v. *Morris Plan Co. of Tampa,* 69 F. 2d 17 (C. A. 5, 1934); *Board of Road Com'rs.* v. *Keil,* 259 Fed. 76, 81-82 (C. A. 6, 1919); *In re Display Stage Lighting Co.,* 56 F. 2d 1046 (S. D. N. Y. 1932); *United States* v. *Southern Constructors, Inc.,* 211 F. Supp. 537 (W. D. Mo. 1962).

In re Hollingsworth & Whitney Co., 242 Fed. 753 (C. A. 1, 1917), cited by petitioner (Petn. 9) does not apply because as the Court there noted, the only question under the agreement was that of ownership. Unlike respondent, the claimant in *Hollingsworth* did not challenge summary jurisdiction before or at the time the agreement was made, nor did

that agreement provide that it was without prejudice to the right to challenge summary jurisdiction.

Petitioner incorrectly argues (Petn. 7-8) that there is a conflict "in principle" between the decision of the Court of Appeals and *American Mannex Corp.* v. *Huffstutler*, 329 F. 2d 449 (C. A. 5, 1964). In *American Mannex Corp.*, the Court held on the undisputed facts that since the asserted adverse claim was obviously colorable, the claimed possession was unlawful and, therefore, the adverse claimant was subject to summary jurisdiction. Clearly, if the alleged adverse claim is not real or substantial, the possession assumed thereunder is not lawful. In the present case the Court of Appeals held that respondent's claim was not merely colorable but was real and substantial and in referring to *American Mannex Corp.*, which was cited below by petitioner, said that the facts in *American Mannex Corp.* were "widely different" from those before it, and further stated that both Courts of Appeal applied the same rules of law in reaching their respective decisions. The results were different only because the facts were different.

Petitioner erroneously states (Petn. 15) that respondent's right to take possession of its collateral is derived from one set of documents. Not only is this irrelevant to the issue before the Court but it is in complete disregard of the facts. The right to take possession of the personalty was clearly granted to respondent in three separate chattel mortgages which pertained to three separate and distinct loans made to the bankrupt over a period of six months (R. Vol. V, 53-57, 62-66, 68-73), and its right as mortgagee under its trust deed (R. Vol. V, 49-52) to take possession of the real estate was conferred by Illinois law. In *Tuttle* v. *Harris*, 297 U. S. 225, 226 (1936), this Court held that, "A mortgagee after condition broken under the law of Illinois is the owner of a legal estate, and as such entitled as of right to the possession of the mortgaged premises."

The substantiality of respondent's adverse claims and its right to take possession of its collateral are indisputably established by the various mortgages above referred to, as well as by the law of the State of Illinois as construed by this Court.

Petitioner erroneously contends here (Petn. 15) as he did below that before taking possession respondent was required to give fifteen (15) days prior notice and in support of this argument refers to a letter given by respondent to the bankrupt in connection with the loan of December 14, 1961. Not only was such notice not required by that letter but petitioner fails to inform this Court that the two subsequent chattel mortgages dated May 24, 1962 (R. Vol. V, 62-66), and June 11, 1962 (R. Vol. V, 68-73), completely superseded and nullified that letter. The two later chattel mortgages specifically provided that in the event of any default thereunder, respondent immediately was entitled to accelerate all payments due it, not only under those later mortgages and notes but all payments due it on all *prior* mortgages and notes, and to take possession without notice (R. Vol. V, p. 62, pars. 4-6; p. 63, par. 5; p. 68, pars. 4-6; p. 69, par. 5). Also, petitioner has never contended that the bankrupt could have cured its extensive defaults referred to at page 3 of this brief, if respondent had given such notice. Where service of notice would be futile, it is not required. *Rothbart* v. *Metropolitan Trust Co.*, 307 Ill. App. 271, 276, 30 N. E. 2d 183 (1940), and *Roy* v. *Goings*, 96 Ill. 361 (1880).

Petitioner asserts (Petn. 9) that the decision of the Court of Appeals conflicts with the decisions in *Buss* v. *Long Island Storage Warehouse Co.*, 64 F. 2d 338 (C. A. 2, 1933); *Teasdale* v. *Robinson*, 290 F. 2d 108 (C. A. 8, 1961); and *Fish* v. *East*, 114 F. 2d 177 (C. A. 10, 1940). *Buss* and *Fish* are not in point because in those cases the courts considered evidence on the merits only to the extent necessary

to enable them to rule on the challenges to summary jurisdiction, that is they merely conducted preliminary inquiries as required by law. Also, in *Fish*, as the Court pointed out at pages 188, 189, 193 and 194 of its opinion, the claimants clearly consented to summary jurisdiction.

Teasdale is also clearly inapplicable because the adverse claim was "... a sham and a pretense," and, as the court noted, the adverse claimant agreed to the hearings on the merits. In that case, therefore, the question of the proper scope of a preliminary inquiry was neither raised nor decided. In the context of the undisputed facts in *Teasdale*, the court's remark, "That was proper practice ...." simply and clearly means that the court may hear only so much of the facts as are necessary to determine whether the adverse claim is real and substantial or merely a sham. As soon as the court concluded that the claim was a sham and a pretense, the preliminary inquiry was concluded and the court then properly proceeded to determine the case on the merits. That the Eighth Circuit is obviously in full agreement with the Seventh Circuit on this question is firmly established by the fact that *Teasdale* cited with approval *In re Kansas City Journal-Post Co.*, 144 F. 2d 812 (C. A. 8, 1944), which was also decided by the Eighth Circuit. In *In re Kansas City Journal-Post Co.*, the Court of Appeals affirmed the district court (51 F. Supp. 1009, 1022) which rejected the contention that a preliminary inquiry is an integral, but indivisible, part of the hearing on the merits. In *In re Kansas City Journal-Post Co.*, the Court of Appeals cited and relied on *Harrison* v. *Chamberlin*.

It is very important to note that in the instant case the Court of Appeals for the Seventh Circuit cited with approval *In re Kansas City Journal-Post Co*. It is apparent, therefore, that no conflict exists between the Eighth and Seventh Circuits on this question. It is equally clear that no conflict exists among any of the circuits on this question.

All of the circuits, without exception, follow the rule of this Court in *Harrison* v. *Chamberlin.*

The decision of the Court of Appeals does not conflict in principle or otherwise with the following decisions cited by petitioner (Petn. 10): *In re Federal Photo Engraving Corp.*, 54 F. 2d 628 (C. A. 2, 1931); *Lieberman* v. *Bancroft*, 69 F. 2d 202 (C. A. 3, 1934); *Universal Oil Products Co.* v. *Cosden Petroleum Corp.*, 178 F. 2d 495 (C. A. 5, 1949); *Kelso* v. *Maclaren*, 122 F. 2d 867 (C. A. 8, 1941); *Trieber* v. *England*, 237 F. 2d 117 (C. A. 9, 1956), cert. denied, 352 U. S. 967 (1957); and *In re Christ's Church of the Golden Rule*, 172 F. 2d 523 (C. A. 9, 1949). Rather, it is apparent that these decisions are completely in accord with the ruling of the Court of Appeals in our case, because as required by *Harrison* v. *Chamberlin*, they ruled on the objections to summary jurisdiction upon completion of the preliminary inquiry. Those cases, therefore, support the decision of the Court of Appeals.

VII.

Orders Overruling Objections to Summary Jurisdiction Are Appealable.

Incredibly, petitioner argues (Petn. 10) that there is no purpose in conducting a preliminary inquiry because orders overruling objections to summary jurisdiction are not appealable. Thus, in one fell swoop petitioner conveniently nullifies all the Supreme Court cases and the extensive body of law requiring preliminary hearings.

A referee's order overruling objections to summary jurisdiction is reviewable by the district court. *Sulmeyer* v. *Pfohlman*, 329 F. 2d 915, 917 (C. A. 9, 1964); sec. 39c of the Bankruptcy Act, 11 U. S. C. A. § 67(c); 2 Collier on Bankruptcy, § 39.21, pp. 1499-1501. And the district court's order is appealable because it derives from a "proceed-

ing" (the petition to sell), rather than a "controversy." *In re Greenstreet, Inc.*, 209 F. 2d 660, 662 (C. A. 7, 1954).

Also, there is sound authority that an order overruling objections to summary jurisdiction in a controversy in bankruptcy is appealable. *Gill* v. *Phillips*, 337 F. 2d 258 (C. A. 5, 1964), (under 28 U. S. C. A. § 1292(b)).

Clearly, in bankruptcy cases appeals may be taken from orders overruling objections to summary jurisdiction. It is equally clear that there is no conflict between the decision of the Court of Appeals in this case and the decisions in the other circuits.

VIII.

The Guaranteed Right to Challenge Summary Jurisdiction May Not Be Nullified.

Petitioner contends (Petn. 7) that the referee's refusal to comply with the law and to conduct a preliminary inquiry is excusable if, despite objections to summary jurisdiction, the referee concludes after a hearing on the merits that he has summary jurisdiction over some of the property involved. Obviously, there is no merit to petitioner's contention because its effect is to nullify completely the valuable right to challenge summary jurisdiction conferred by Congress and repeatedly protected by this Court. In *Board of Education of Salt Lake City, Utah* v. *Leary*, 236 Fed. 521 (C. A. 8, 1916), which this Court cited with approval in *Harrison* v. *Chamberlin*, 271 U. S. 191, the Court of Appeals at p. 526 said:

> "If this right guaranteed by the law and uniformly recognized by the courts can be extinguished by an ultimate adverse decision on the merits, it becomes at once unsubstantial and valueless."

It is also important to note that the right of an adverse claimant to challenge summary jurisdiction is not lost

simply because some of the property of which he took possession may not be subject to his claims. This Court in *Louisville Trust Co.* v. *Comingor,* 184 U. S. 18 (1902), held that possession by an adverse claimant of property which is not subject to his claims, does not deprive him of his right to challenge summary jurisdiction as to the other property claimed and held by him. The same rule was followed in *In re Rosenberg,* 128 F. 2d 924, 926 (C. A. 7, 1942), *City and County of Denver* v. *Warner,* 169 F. 2d 508, 512 (C. A. 10, 1948), and *In re Brokol Manufacturing Company,* 221 F. 2d 640, 642-3 (C. A. 3, 1955).

Petitioner inexplicably argues (Petn. 13) that the decision of the Court of Appeals will foster illegal seizure by adverse claimants who may seek to delay administration of bankruptcy proceedings. The fact is that the decision of the Court of Appeals which complies with the mandate of *Harrison* v. *Chamberlin* and the other decisions of this Court effects an opposite result. The preliminary inquiry avoids ultimate delay because it is the sole purpose of that hearing to determine promptly whether the adverse claim is real and substantial or merely colorable. The elimination of the preliminary inquiry, as urged by petitioner, would inevitably burden future cases with the same costly, unnecessary delay that regrettably has occurred in this case.

Petitioner cannot nullify respondent's well established right to challenge summary jurisdiction and to have its rights determined in a plenary action by simply asserting that these rights are procedural (Petn. 13). Respondent is entitled to have a jury trial and has so demanded in petitioner's plenary action (R. Vol. V, 2, 94). This valuable right is unavailable in a summary proceeding. The law is well established that respondent cannot be denied its right to trial by jury on the various issues of fact common to petitioner's law and equity claims and respondent's

counterclaims and third party actions. *Beacon Theatres* v. *Westover*, 359 U. S. 500, 503-04, 510-11 (1959), *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962).

SUMMARY.

Petitioner fails to set out any special or important reason in support of his petition for the writ of certiorari.

The question presented here has been adjudicated many times by this Court in cases which were cited to the referee at the very commencement of the litigation almost four years ago. Those cases were also cited to the district court and the Court of Appeals. It was on the basis of those cases that the Court of Appeals reversed.

The Court of Appeals found that it was not the respondent but rather the petitioner who was responsible for the substantial waste and extensive delay in this case. To prevent further delay and waste, the Court of Appeals directed the parties to proceed expeditiously in the petitioner's pending plenary action. Petitioner, however, refuses to do so and argues for further delay.

It is apparent that this case involves complicated issues of fact and law affecting the rights and claims not only of petitioner and respondent but of many other persons including former officers, directors and shareholders of the bankrupt corporation who, petitioner charges, in his plenary action, misappropriated $1,438,555 of the proceeds of respondent's loans to the bankrupt. In the same plenary action, respondent charges the same officers, directors and shareholders with fraud and deceit in connection with the loans made by it to the bankrupt. Clearly, therefore, the district court in which the plenary action is pending is the ideal and only forum for determination in one trial of all of the contested, complicated issues. It is impossible to achieve this result in the summary proceeding.

It has never been denied that respondent has secured claims for $3,764,724 against the bankrupt for moneys actually loaned. Respondent has not yet had its day in court on the merits of its claims. In the plenary action, respondent filed its answer, counterclaims and third party complaint. In that action the court, with all the necessary parties before it, will adjudicate in one trial the rights and claims of all the litigants.

CONCLUSION.

It is respectfully submitted that the petition should be denied.

Respectfully submitted,

NORMAN H. NACHMAN,
JOSEPH STEIN,
ALLAN G. SWEIG,
Attorneys for Respondent.

APPENDIX A.

IN THE UNITED STATES DISTRICT COURT
For the Northern District of Illinois,
Eastern Division.

EDWARD LIMPERIS, Successor Trustee in Bankruptcy of PROCESS-MANZ PRESS, INC., Bankrupt, *Plaintiff*, *vs.* A. J. ARMSTRONG CO., INC., a corporation; MORRIE A. MOSS, LESTER A. NEUMANN and CAROLYN D. MANZ, *Defendants.*	Civil Action No. 65 C 145

AMENDED COMPLAINT.

Now comes Edward Limperis, Successor Trustee in Bankruptcy of Process-Manz Press, Inc., Bankrupt, in Case No. 62 B 9414, now pending in the United States District Court for the Northern District of Illinois, Eastern Division, by his attorney, William S. Collen, and complaining of the defendant, A. J. Armstrong Co., Inc., a New York corporation, and defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz, says:

Count I.

1. Plaintiff is the Successor Trustee in Bankruptcy of Process-Manz Press, Inc., an Illinois corporation, sometimes hereinafter referred to as the "Bankrupt" or as ("Manz"). Said bankruptcy proceeding is cause No.

62 B 9414 pending in the United States District Court for the Northern District of Illinois, Eastern Division. An order of adjudication was entered against said Bankrupt in the aforementioned proceeding on January 31, 1963.

2. The defendant, A. J. Armstrong Co. Inc., (hereinafter referred to as "Armstrong") is a New York corporation engaged in the finance business. It is the successor in interest to City Industrial Company, a New York partnership, also engaged in the finance business. Armstrong had divers dealings with the Bankrupt as a financier over a protracted period of time as hereinafter set forth, not in the manner as is customary between a borrower and lender but in the manner hereinafter described.

3. Plaintiff brings this action under Section 67(e) and 70(8) (3) of the Bankruptcy Act (11 U. S. C. Sections 107(c) and 110(c) (3)). This Court has jurisdiction under said statutory provisions.

4. Manz had engaged in the printing business for over ninety years, occupying a large building situated on more than one-half city block at 4043 North Ravenswood Avenue, in Chicago, Illinois. It had been formerly known as Manz Corporation, its name having been changed to Process-Manz Press, Inc., in May 1962. Its annual volume of business was six million dollars.

5. A company known as Process Lithographers, Inc., is a New York corporation (hereinafter referred to as ("Lithographers"), was at times hereinafter referred to engaged in the printing business in New York City. It has since been adjudicated a bankrupt in a proceeding in the United States District Court for the Southern District of New York.

6. On March 20, 1961, three holders of ninety-one percent (91%) of the stock of Manz (Moss, Neumann and Kessler) entered into a written contract for the sale of

all their stock, preferred and common, to Lithographers, said contract provided for payment of $2,236,083.04 to said stockholders. One of said stockholders (Moss) was to receive payments over a period of five years. Another of said stockholders, (Neumann) was to receive payments over a four-year period. A minority (10%) third stockholder (Kessler) was to be paid in full in seven months or by October 15, 1961. Neumann was to receive a substantial payment on account ($172,833.33) on August 1, 1961. Said contract provided for the immediate resignation of all officers and directors of Manz. Said contract further provided that the purchaser would have the right to cause Manz to sell, encumber or dispose of all or any part of the assets other than in the usual course of business provided that the purchaser should pay to the selling stockholders an amount equal to one-half of the cash proceeds of any such sale or hypothecation; said contract vested full voting rights of the shareholders in Lithographers so long as there was no default.

7. New officers and directors were elected by Lithographers on or about March 20, 1961. Lithographers thereupon assumed full possession and control of and operated the business of Manz thereafter.

8. Monthly payments provided in said contract were made by Lithographers to the selling shareholders until August 1, 1961. It was unable to pay the full installment due to Neumann on August 1, 1961, of $172,833.33 and paid only $50,000.00 on account. The balance of said installment was not paid until October 16, 1961.

9. Prior to said date, on October 4, 1961, the new officers of Manz (being the same as those of Lithographers) entered into an agreement with Armstrong for a secured loan of $1,000,000.00 in behalf of Manz, out of said loan $500,000.00 was to be paid to Manz and $500,000.00 was to be held by Armstrong in escrow pursuant to authorization

granted by Moss and Neumann for the mortgaging of the assets of Manz.

10. From the proceeds of said loan of October 4, 1961, Manz advanced $289,231.75 to Lithographers, and Lithographers used the proceeds received from Manz to pay the balance due to Neumann in the sum of $172,833.33 for the installment due August 1, 1961, previously referred to.

11. After the loan of October 4, 1961 was consummated, negotiations were commenced between Armstrong and Manz for a secured loan of approximately $3,000,000.00. In the negotiation for the $3,000,000.00 loan as aforedescribed, as conditions precedent to the making of said loan, Armstrong, in addition to the security of the trust deed on the real estate and a chattel mortgage on all of the personal property of Manz, required as conditions to said loan of Manz, (1) deposit with it of one hundred percent (100%) of the shares of stock of Manz as collateral, (2) an exclusive contract for all of the financing of accounts receivable which was required to be continued in effect so long as Manz was indebted to Armstrong, and (3) the guaranty of said loan by Lithographers and by Solomon Roskin, who was President of Manz and Lithographers.

12. Pursuant to said conditions, Manz on October 31, 1961, signed a contract with Armstrong for the exclusive discounting of all its accounts receivable, Manz thereafter forwarded all of its receipts to Armstrong and Armstrong made advances to Manz in various round figures, the accounts receivable assigned to Armstrong included rents derived from the tenants of Manz.

13. Pursuant to said conditions imposed by Armstrong for the making of said loan, Lithographers, on November 6, 1961, assigned to Armstrong, all of its right, title and interest in and to its contract of March 20, 1961, for the purchase of the shares of stock of Manz, purportedly as collateral for the proposed loan. On November 6, 1961,

Lithographers delivered to Armstrong, all shares of stock of Manz paid for and acquired by it to that date. The assignment of November 6, 1961 further provided that Armstrong should have the privilege of making payments on said contract of March 20, 1961, in the event of any default by Lithographers in the payment of installments due the selling shareholders. On November 6, 1961, Lithographers confirmed by letter to Armstrong the said assignment agreement and made a commitment to use its best efforts to purchase one hundred percent (100%) of the shares of stock of Manz and to deliver said shares to Armstrong.

14. Pursuant to the conditions imposed by Armstrong, as aforesaid, the following transaction occurred on December 14, 1961. Manz executed a trust deed transferring all of its real estate and a chattel mortgage transferring all of its tangible personal property (excluding inventory and work in process) to Armstrong. Manz also executed a promissory note for $2,500,000.00 bearing interest at 12% per annum. All said documents were thereupon delivered to Armstrong. In return therefor, Armstrong on the same date, disbursed the proceeds of the $2,500,000.00 loan as follows:

(1) It repaid itself the sum of $500,000.00 borrowed from it by Manz on October 4, 1961 (and released to itself the $500,000.00 held in escrow pursuant to the loan agreement);

(2) It paid itself $11,666.67 in interest on the loan of October 4.

(3) It paid $2525.00 to its counsel for attorney's fees and title expenses.

(4) It delivered two checks payable to the order of Schwartz, Nathanson & Frank, attorneys for Manz, to George Schwartz, one check being in the amount of $814,432.58 and one for $624,122.49, said two checks being for a total amount due of $438,555.07; and

(5) It issued a check payable to Manz for $547,-253.26.

This latter check represented the actual cash proceeds received by Manz from this transaction. The two checks delivered to Schwartz were delivered on the conditions stipulated by Armstrong and under the direction of Armstrong that the amount of the first check be paid to Moss and the amount of the second check be paid to Neumann to prepay Moss and Neumann the respective total balances due to them on the contract of March 20, 1961, and that Schwartz receive in return from Moss and Neumann the balance of the shares of stock of Manz covered by these payments and deliver them to Armstrong as collateral for its loan in accordance with the terms of the loan. Upon receipt of said two checks Schwartz exchanged them for two certified checks in identical amounts payable respectively to Moss and Neumann. Schwartz then delivered these certified checks to Moss and Neumann from whom he had already obtained the remaining balance of stock (both preferred and common) and for whom he was acting as escrow agent. Schwartz delivered to Armstrong the shares of Manz stock which he had received from Moss and Neumann and thereupon certified to Armstrong that he had "this day made payment to the selling shareholders under the agreement of March 20, 1961 of the sums which we computed to be the balance provided for under said agreement", and further that in his opinion "there is no prohibition or restriction of any nature under the terms of said agreement which would prevent Manz from mortgaging its assets or assigning its accounts receivable".

15. On December 14, 1961 several creditors of Manz had substantial claims which are still due and owing.

16. As a result of the payment of $1,438.555.97 to the said selling shareholders from the proceeds of the loan

of December 14, 1961, Lithographers became indebted to Manz in said amount by reason of the fact that said payment discharged the debt of Lithographers in that amount to said shareholders and was of no benefit whatsoever to Manz. Recognizing Lithographers' inability to pay said debt to Manz, the officers and agents of Lithographers and the officers and agents of Armstrong arranged for and effected a purported redemption of preferred stock by Manz to an amount covering said debt of $1,438,555.07, plus an additional sum in excess of $500,000.00 representing cash advances and printing jobs performed by Manz for and in behalf of Lithographers. The total redemption of stock was $1,979,640.00 and cancelled a debt of Lithographers to Manz in that amount and was effected by Armstrong's surrendering shares of stock of Manz held by it in an equivalent amount to Lithographers for redemption.

17. Immediately following the consummation of said loan of December 14, 1961, Manz was in default under the terms of said loan by reason of its failure to comply with the loan requirements pertaining to minimum net working capital and minimum net worth. At the time of said loan Manz was indebted to its creditors in approximately the sum of $590,000.00 and was unable to pay its debts in the regular course of business as they became due. Prior to the time of the making of said loan of December 14, 1961 and continuously thereafter, Manz's financial condition progressively worsened from December 14, 1961 to the date of bankruptcy, November 23, 1961. On the latter date Manz was indebted to general creditors in a sum in excess of $1,000,000.00 and to wage earners in the sum of approximately $50,000.00 and to tax claimants, including withholding taxes due the United States of America in the sum of $107,000.00.

18. On November 21, 1962, Armstrong, without giving any notice to Manz, attempted to take possession of all the

property of Manz, and Armstrong, placed Pinkerton guards at the entrance to the plant and posted notices asserting that all of the premises and all of the property of Manz was in its exclusive possession.

19. On November 23, 1962, an involuntary petition in bankruptcy was filed as hereinabove described. On November 26, 1962, Francis J. Curtis was appointed Receiver. On said date an order was entered directing said Receiver to forthwith take possession of all of the property of the bankrupt. On November 27, 1962, said Receiver entered into possession of the property of Manz and continued in such possession until his appointment as Trustee on February 15, 1963. During said period the Receiver and Trustee operated the business of the bankrupt solely by reason of the request of and financial assistance from Armstrong. Edward Limperis was elected and qualified as the Successor Trustee upon the death of Francis J. Curtis.

20. By reason of the transactions hereinabove described between Manz and Armstrong, Manz did not receive "fair consideration" as defined in Section 67d of the Bankruptcy Act, since a substantial portion of its assets were mortgaged to pay the debt of Lithographers to the damage and detriment of the creditors of Manz, all with the full knowledge of Armstrong, as follows:

(a) By said transaction Manz transferred its property and incurred an obligation without fair consideration and was insolvent or was thereby rendered insolvent;

(b) Manz made a transfer and incurred a debt without fair consideration at a time when it was about to engage in such business or transaction for which the property remaining in its hands was an unreasonable small capital;

(c) Manz made a transfer and incurred a debt without fair consideration with intent on the part of its officers and agents that it would incur, or that they believed that it would incur debts beyond its ability to pay as they mature;

(d) Manz made a transfer or incurred a debt, which transfer was made and debt was incurred with actual intent to hinder, delay or defraud existing or future creditors.

All of the foregoing being in violation of Sections 67d, (2), of the Bankruptcy Act.

21. By reason of the transactions hereinabove described between Manz and Armstrong, Manz incurred an obligation and made a transfer of its property contrary to and in violation of Secton 70e of the Bankruptcy Act, which incorporates state law as grounds for invalidation. Said transfers were fraudulent and void under the laws of Illinois pertaining to fraudulent conveyances, being Ill. Rev. Stat. ch. 59, Section 4. Said transfers by Manz, together with the redemption of stock as hereinabove described, were made pursuant to a conspiracy among Armstrong, Lithographers and Manz to cause an illegal redemption in violation of Sections 6 and 58 of the Illinois Business Corporation Act, being Ill. Rev. Stat. ch. 32, Sections 157.6 and 157.58.

22. The transfers hereinabove described by Manz to Armstrong were in the form of a trust deed executed by Manz to City Industrial Co. (predecessor of Armstrong), on the real estate of the bankrupt, securing a note in the sum of $2,500,000.00, in which the Chicago Title and Trust Company is the Trustee, Identification No. 425566, and recorded as Document No. 18357738, together with a chattel mortgage executed on December 14, 1961 by Manz to City Industrial Co., securing the same note and recorded as

Document No. B3479317. Said transfers and conveyances are null and void for the reasons hereinabove stated.

23. On or about December 14, 1961, Armstrong, by reason of the transactions hereinabove described, held in excess of ninety-one percent (91%) of the shares of stock of Manz (having acquired additional shares from shareholders other than the selling shareholders) under the terms of a secured loan agreement with which it was impossible for Manz to comply and under which Manz became immediately in default; held a first and prior lien on all the assets of the bankrupt (excluding inventory and work in process); held an assignment of all accounts receivable of Manz under an agreement requiring the receipt by Armstrong of copies of all invoices representing accounts receivables created by Manz, together with all receipts of Manz. From said date, no officer or director of Manz owned or held any shares of stock of Manz, no corporate minutes of shareholders or of directors were held by Manz; all necessary authorizations for corporate action were performed without any interest or control on the part of shareholders of Manz, but at the direction of Armstrong. By reason of the foregoing, Armstrong became the owner and parent of Manz, and Manz was thereafter in effect the alter ego, tool, adjunct and instrumentality of Armstrong used for the sole purpose of advancing the financial interest of Armstrong to the great detriment and damage to the creditors of Manz.

24. On May 24, 1962 Manz executed a chattel mortgage to Armstrong, securing a note in the sum of $75,000.00, on equipment therein described. Said chattel mortgage was recorded as Document No. B-3512834. On June 11, 1962, Manz executed a chattel mortgage to Armstrong, securing a note in the sum of $10,000.00, on equipment therein described, said chattel mortgage was recorded as Document No. B-3517662. The loans secured by said chattel mort-

gages were, by reason of the matters hereinabove set forth, in substance capital contributions by Armstrong.

25. The matters set forth hereinabove are presently the subject of a summary proceeding in the aforementioned bankruptcy proceeding now pending in this Court, being Cause No. 62 B 9414. On November 27, 1963 the Honorable Lawrence J. Miller, Referee in Bankruptcy, entered an order in said cause holding that the Court had summary jurisdiction and deciding the merits of the matters presented herein and other matters. On December 4, 1964 said order of Referee Miller was affirmed, on the petition of review of Armstrong therefrom, by the Honorable William J. Campbell, Chief Judge. On December 29, 1964 Armstrong filed a notice of appeal from the judgment entered by Judge Campbell to the United States Court of Appeals for the Seventh Circuit. Said appeal is presently pending. Plaintiff files this Complaint seeking relief in the alternative in accordance with Federal Rule 8(a), solely for the purpose of preserving the rights of creditors of said bankruptcy estate, since the applicable statute of limitations, Section 11e of the Bankruptcy Act, bars any action predicated on the matters set forth herein after January 31, 1965. Plaintiff files this Complaint in accordance with the order of the Court entered January 27, 1965 authorizing and directing the filing of same solely for the purpose immediately hereinbefore stated.

Wherefore, plaintiff prays that a decree be entered by this Court ordering, decreeing and adjudging that the transfers of property by Process-Manz Press, Inc. to A. J. Armstrong Co. Inc. of December 14, 1961, of May 25, 1962 and June 11, 1962, as more particularly described hereinabove, be cancelled, set aside and declared to be null and void and of no effect whatsoever, and further that a decree be entered by this Court adjudging Manz to be the alter ego and instrumentality of Armstrong, and that Armstrong

was in effect the owner of Manz, and your plaintiff prays for such other and further relief as to the Court and equity may deem meet.

COUNT II.

1-17. Plaintiff realleges paragraphs 1-17 of Count I hereof.

18. Defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz were shareholders of the Bankrupt, all of whose stock had been deposited in escrow with said George Schwartz as hereinabove alleged prior to December 14, 1961.

19. On December 14, 1961 defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz collectively received for their said shares of stock in the Bankrupt the payments hereinabove alleged aggregating in amount $1,438,555.07.

20. On December 14, 1961 the Bankrupt was indebted to its creditors in the amount of approximately $590,000.00.

21. On December 14, 1961 the Bankrupt was insolvent and had no earned surplus, and its net assets were less than its stated capital.

22. The aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz made on December 14, 1961 at the direction of defendant A. J. Armstrong Co., Inc. rendered the Bankrupt insolvent and reduced its net assets below its stated capital.

23. Section 6 of The Business Corporation Act of the State of Illinois [Ill. Rev. Stat. ch. 32 § 157.6 (1961)], in effect at all times mentioned herein, provides as follows:

> "A corporation shall have power to purchase, take, receive, or otherwise acquire, hold, own, pledge, transfer, or otherwise dispose of its own shares, provided that it shall not purchase, either directly or indirectly,

its own shares when its net assets are less than the sum of its stated capital, its paid-in surplus, any surplus arising from unrealized appreciation in value or revaluation of its assets and any surplus arising from surrender to the corporation of any of its shares, or when by so doing its net assets would be reduced below such sum. Notwithstanding the foregoing limitations, a corporation may purchase or otherwise acquire its own shares for the purpose of:

(a) Eliminating fractional shares.

(b) Collecting or compromising claims of the corporation, or securing any indebtedness to the corporation previously incurred.

(c) Paying dissenting shareholders entitled to payment for their shares under the provisions of this Act.

(d) Effecting, subject to the other provisions of this Act, the retirement of its redeemable shares by redemption or by purchase at not to exceed the redemption price.

No purchase of its own shares shall be made at a time when the corporation is insolvent or when such purchase would render the corporation insolvent."

24. Section 58 of The Business Corporation Act of the State of Illinois [Ill. Rev. Stat. ch. 32, § 157.58 (1961)], in effect at all times mentioned herein, provides in part as follows:

"No redemption or purchase of redeemable shares shall be made which will reduce the remaining assets of the corporation below an amount sufficient to pay all debts and known liabilities of the corporation as they mature, except such debts and liabilities as have been otherwise adequately provided for, or which will reduce the net assets below the aggregate amount payable to the holders of shares having prior or equal rights to the assets of the corporation upon dissolution."

25. The aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz on December 14, 1961 were in violation of Sections 6 and 58 of the Illinois Business Corporation Act [Ill. Rev. Stat. ch. 32, §§ 157.6 and 157.58 (1961)].

26. By virtue of § 70e of the Bankruptcy Act, said Sections 6 and 58 of the Illinois Business Corporation Act and the common law of Illinois, particularly as declared in *Reilly* v. *Segert*, 31 Ill. 2d 293 (1964), plaintiff, as representative of the creditors of said bankrupt, is entitled to recover the aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz.

27. The matters set forth hereinabove are presently the subject of a summary proceeding in the aforementioned bankruptcy now pending in this Court, being Cause No. 62 B 9414. Plaintiff files this Complaint seeking relief in the alternative in accordance with Federal Rule 8(a) in the event that it is finally determined plaintiff is not entitled to relief in said summary proceeding.

Wherefore, Plaintiff prays judgment against defendant Morrie A. Moss in the amount of $814,432.58 and against defendants Lester A. Neumann and Carolyn D. Manz in the amount of $624,122.49, together with costs of this suit.

WILLIAM S. COLLEN,
Attorney for Plaintiff,
100 West Monroe Street,
Chicago, Illinois 60603.

SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
MAR 1 1967
JOHN F. DAVIS, CLERK

No. 909

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

EDWARD LIMPERIS, TRUSTEE
IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.
Petitioner,

v.

A. J. ARMSTRONG CO., INC.
Respondent.

REPLY BRIEF OF PETITIONER

WILLIAM S. COLLEN
100 West Monroe Street
Chicago, Illinois 60603

JOSEPH L. KADISON
134 North LaSalle Street
Chicago, Illinois 60602

WILLIAM B. DAVENPORT
135 South LaSalle Street
Chicago, Illinois 60603
Attorneys for Petitioner

UNITED STATES LAW PRINTING CO., CHICAGO 18, ILL. LA review 5-6581

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 909

EDWARD LIMPERIS, TRUSTEE IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.

Petitioner,

v.

A. J. ARMSTRONG CO., INC.

Respondent.

REPLY BRIEF OF PETITIONER

Respondent's brief in opposition is more an extended argument on the facts than it is a discussion of the reasons involved in the exercise of this Court's certiorari jurisdiction.

Respondent re-asserts the argument, rejected in both the majority and dissenting opinions of the Court below, that it has not had a day in court (Br. pp. 10, 18, 28). On the contrary, the Court below noted respondent's refusal to participate in the complete hearing afforded by the referee and held that it was not required to participate but was entitled to take the risk that if it was wrong on the jurisdictional issue, judgment would be rendered against it accord-

ingly. See App. to Pt. pp. 8-9, 369 F. 2d at 517. The portions of the record which respondent quotes (Br. pp. 6-7) amply support the conclusion of the *entire* Court below that respondent has had its day in court.

The controlling question here is whether respondent, who asserts the status of an adverse claimant, may oust the bankruptcy court of *all* jurisdiction as to *all* assets of the bankrupt, including assets which the Court below held respondent "obviously had no right to possess" (App. to Pet. p. 12; 369 F. 2d at 519), and require the trustee to initiate a plenary suit under §23 of the Bankruptcy Act as to *all* such assets—even though the claim to *all* the assets is derived from one set of documents. Respondent argues that §23b of the Act (11 U.S.C. §46b) is also involved (Br. pp. 1-2). Section 23b does not become pertinent until disposition is made adversely to petitioner of the issue of summary jurisdiction under §2a(7). See 2 COLLIER, BANKRUPTCY ¶23.03 (14th ed. 1966).

Respondent denies the jurisdiction of the bankruptcy court in cases where a lienholder has seized both mortgaged assets and free assets of a bankrupt and defies the court by refusing to disgorge the free assets. In *Louisville Trust Co.* v. *Comingor*, 184 U.S. 18 (1902), cited by respondent (Br. p. 26), the adverse claimant voluntarily disgorged assets to which he had no claim.

Respondent's assertion of a claim to the property excluded from the chattel mortgage (*i.e.*, the work in process and inventory) and the property of reclamation creditors in which the bankrupt had an equity (R. 260-61, ¶¶ 9 and 10), which claim was inseparable from respondent's claim to the other assets of the bankrupt, compelled the referee, in the exercise of summary jurisdiction conceded to him by the Court below, to conduct a hearing into the merits of

respondent's claim thereto. Stated otherwise, by refusing to disgorge the assets which the Court below held it "obviously had no right to possess," respondent required the bankruptcy court to conduct a hearing on the merits concerning respondent's claim thereto. The majority held this exercise of summary jurisdiction proper.

Under well established principles of *res judicata* and collateral estoppel, the referee's adjudication in the exercise of his conceded jurisdiction is binding upon respondent as to the remaining assets in a plenary proceeding. *Katchen* v. *Landy*, 382 U.S. 323, 334 (1966); *Chicot County Drainage District* v. *Baxter State Bank*, 308 U.S. 371, 375 (1940); *Stoll* v. *Gottlieb*, 305 U.S. 165 (1938). In denying *res judicata* effect to the valid exercise of summary jurisdiction as to a subsequent plenary proceeding, the majority opinion of the Court below conflicts in principle with the decisions of the three Circuits cited in the petition (Pet. p. 7), each of which gives *res judicata* effect to a prior summary proceeding.

The majority opinion thus concludes that unless a referee's adjudication binds all property over which an adverse claimant asserts a possessory right, it has no *res judicata* effect—*even as to assets which the claimant "obviously had no right to possess."* No precedent is cited for this holding. The clear error in this holding alone is of a magnitude sufficient to warrant the exercise of this Court's supervisory powers over lower federal courts to prevent a miscarriage of justice. If permitted to stand, the majority opinion below may become a model for protracted administration by fragmentation.

Respondent's basic argument is that even if summary jurisdiction does exist as to a part of the assets which it claims, still a plenary suit should be required since it

provides a more convenient forum in view of the multiple claims made by respondent against third parties. The filing of the plenary suit was made at the direction of the referee to toll the statute of limitations. (R. 1075.) The plenary suit sought relief in the alternative under Federal rule 8(a), relief that is unnecessary if summary jurisdiction exists. The Court below held that it did exist in part, a holding which respondent does not challenge and which under well established rules is *res judicata.* See *supra,* p. 3. Respondent's argument of a more convenient forum thus misses the mark, especially since the presence of petitioner is not required for the adjudication of any claims which respondent may have against any third parties. Reinstatement of the judgment of the District Court would leave respondent entirely free to pursue any and all claims it may have against third parties. Repetition of the voluminous evidence in the record here would be unnecessary. See Dissenting Opinion in Court below, App. to Pet., p. 14; 369 F.2d at 519.

Contrary to respondent's contention (Br. p. 15), the petition does not urge that the long established distinction between summary and plenary jurisdiction be judicially abolished. The petition urges only that in the interest of expeditious judicial administration, in a day that requires rapid movement of litigation through the courts, unnecessary suits be removed from the dockets of the courts. This can be done within the confines of the Bankruptcy Act as it presently stands.

Petitioner does not, contrary to respondent's argument (Br. p. 16), attribute responsibility for the delay and waste herein to the majority of the Court below. Petitioner attributes it to the confused state of the law. Petitioner asks this Court to remove this confusion and

clarify hearing procedure in bankruptcy cases. The confusion exists because of certain language of this Court in *Harrison* v. *Chamberlin,* 271 U.S. 191 (1926), and the provisions of Federal Rule 12, principally paragraphs (b) and (d). Petitioner asks that this Court re-examine *Harrison* v. *Chamberlin* in the light of Federal Rule 12. If the waste in this case can be attributed to any factor other than a confused state of the law, it is attributable to respondent. Respondent prevented the liquidation of the estate more than three years ago, at a time when three fourths of the waste to date could have been avoided. See Pet., pp. 5-6, 13.

Respondent attempts to undermine petitioner's position on the merits of this case by impugning the integrity of one of petitioner's counsel. See Br. pp. 12-13. This attempt is irrelevant to the question of whether certiorari should be granted, is based upon statements not of record, and is unprofessional. Respondent refers to an attorney-client relationship between Louis Kessler, a partner of one of the petitioner's three attorneys, and Lester Neumann, a former stockholder of the bankrupt.* This innuendo was first raised by respondent in its brief in the Court of Appeals and was obviously ignored by that Court. It should be ignored by this Court. Intrusion of such matters into the case on the appellate level is merely an attempt to lead this Court into irrelevancies and can have no bearing on the rights of the numerous creditors of this estate. Whatever claim, if any, respondent may have against Louis Kessler can and should be litigated separately from the propriety of respondent's dealings and misdealings with the bankrupt.

---

* The only record reference cited by respondent, R. 672, shows merely that *respondent* was aware of an attorney-client and business relationship between Kessler and Neumann on November 21, 1962.

Respondent's brief is noteworthy for its failure to mention the conflict between the majority opinion's holding that the issue of lawfulness of possession is for the plenary suit, and the several decisions of this Court, as well as of other Circuits, holding that this issue is for the bankruptcy court. To permit such authority to stand can only create additional confusion in the already complex subject matter of a bankruptcy court's summary jurisdiction.

The petition adequately demonstrates that clarification of procedural law in bankruptcy is needed, and needed urgently, in order to reduce waste involved in litigation of the issue of summary jurisdiction.

Respectfully submitted,

WILLIAM S. COLLEEN
JOSEPH L. KADISON
WILLIAM B. DAVENPORT
Attorneys for Petitioner